GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

September 2nd

Mr André Laboul
Head of Division
Financial Affairs Division
OECD

Re: Comments on the OECD "Contribution of insurance to economic growth and financial stability"

Dear Mr André Laboul,

The Global Federation of Insurance Associations (GFIA) through its 35 member associations represents insurers that account for around 88% of total insurance premiums worldwide.

GFIA welcomes this report by the OECD, as it represents an in-depth, well-researched and much-needed analysis of insurers' contribution to economic growth and financial stability. In particular, GFIA appreciates the extensive references made in the report to a number of key features of the insurance model which ensure that the industry plays a positive role in financial stability and contributes to long-term sustainable growth through investing long-term (e.g. liability driven investment approach with expected future claims matched with generally long term assets, low liquidity risk largely as a result of payments to policyholders being contingent on occurrence of an insured event and the availability of time in the event of a claim, high degree of substitutability and the ability of a failure within the sector to be resolved in an orderly manner should the need arise).

However, this could be further strengthened through a more direct link being made between insurers as long-term investors and real economic growth as well as financial stability. That is, the continual flow of premiums, even in periods of market downturn, enables insurers to be a source of liquidity and to buy assets when many other market players sell. This means that the industry has a counter-cyclical and stabilising effect on financial markets and the economy.

GFIA has some reservations with respect to the second part of the report in which the systemic relevance of insurers is being discussed. Consequently, we would like to take this opportunity to make a few comments and observations on a number of relevant sections.

In addition, it is worth noting that the report's conclusions are mainly based on existing studies and past experiences. However, given the current macroeconomic environment (including bank deleveraging), the authors should also stress the need for policymakers working on debt crisis resolution proposals to bear in mind the on-going positive growth contribution from the insurance industry.

Paragraph 39, 40

These paragraphs would benefit from a greater focus on the important role insurers play as long-term investors ($25 trillion assets under management in 2011) and the impact of regulation on insurers ability to continue to invest long-term. In particular, policymakers need to bear this in mind when thinking about debt crisis resolution proposals. The intermediation role provided by insurers has the potential to reduce the economy's dependency on the banking sector.

Paragraph 43

GFIA believes that the last phrase of this paragraph, which states that "A failure on the part of the insurance sector to deliver on its promises may therefore have significant economic and social consequences, some of which could be systemic in nature", should be deleted. Reference is made here to failure of the 'insurance sector' as a whole not individual institutions please see comments below, is this really what the author intended? In any case, if the author did intend to refer to individual institutions there is no evidence or study cited in the paper showing that traditional activities could pose systemic risk, as recognised in paragraph 54 of this very report; therefore, the sentence should be deleted..

Paragraph 46, 53, 54, 55 and in general

GFIA believes that the definition of systemic risk used in the report is too broad. It is important to distinguish between systemic relevance of an entire sector and systemic relevance of an individual institution. The insurance sector as a whole may be considered as systemically relevant. Without a functioning insurance sector, there would be distortions to the financial markets and damage to the real economy. However, it is a different question as to whether an individual company could cause a systemic event. This distinction is addressed in paragraph 90, however, needs also to be better distinguished in the remainder of the paper.. For example, paragraph 54 states "*a number of reports have been prepared to address the question of whether the insurance sector is systemically important"*, this should instead read *"a number of reports have been prepared to assess whether individual insurance companies pose a systemic risk".* So far the work conducted by the IAIS, FSB and others has focused on 'individual institutions' not the insurance sector as a whole.

When discussing systemic risk in insurance, a much more sector-specific approach is needed, one that would target specifically those activities that have the potential to be systemically risky and take account of existing frameworks at national or regional level. In this respect, we believe that it is important that each activity is looked at individually in the correct context before deciding on its systemic relevance. When it comes to "non-traditional" and "non-insurance" activities (NTNI), we believe it is important to recognize that just because an activity is deemed to be NTNI does not necessarily mean that it should be regarded as systemically relevant.

While a gap in coverage relating to traditional insurance activities may, in exceptional circumstances, cause a temporary disruption in a particular economic sector, this does not constitute a systemic event. This contrasts with the banking sector, where a disruption in key infrastructure (e.g. the payments system) has an immediate systemic knock-on effect on the global financial system and economic activity.

Paragraphs 67-69

To the extent that they are non-substitutable and may become unavailable in case of a big insurer's failure, some NTNI activities such as CDS writing and securities lending may have the potential to generate systemic risk, due the high level of interconnectedness that they create within the financial sector.

However, it is important to remember that in general insurers undertake such activities to enable a more efficient and dynamic matching of assets and liabilities. Furthermore, the above-mentioned activities have the potential to generate systemic risk only under limited and specific circumstances, such as being undertaken on a massive scale, being undertaken with a speculative purpose and not being subject to appropriate risk management.

Paragraph 72

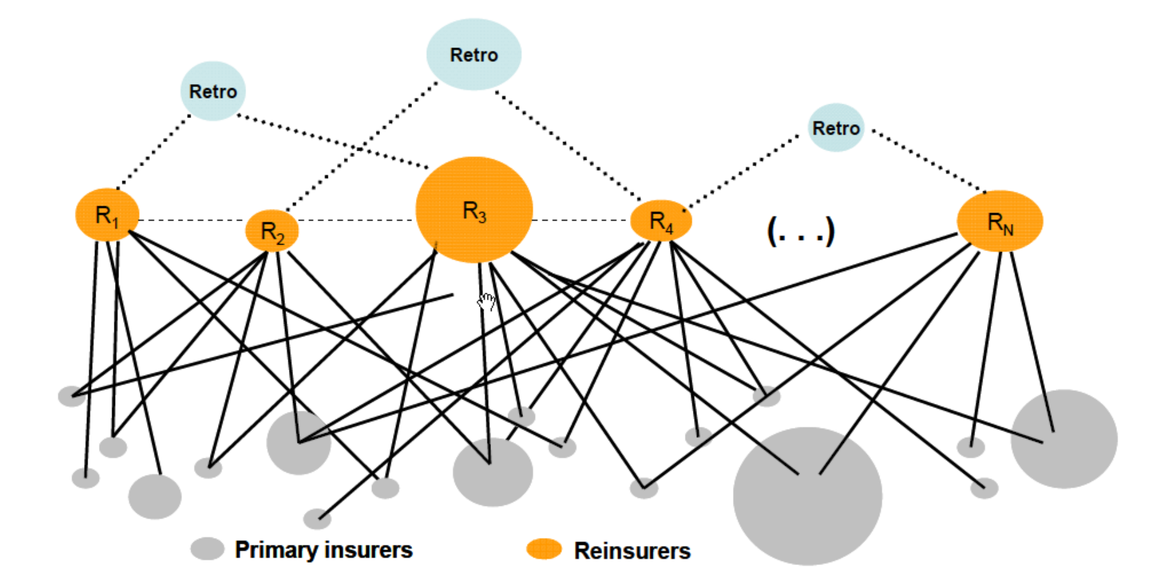
It is important to note that providing long-term funding is not insurers' primary role, but a consequence of the insurance business model, whereby a large amount of investment is made to back future claims, many of which are long-term in nature. This not only brings benefits in terms of ensuring sustainable economic growth but also enhances financial stability through providing an anti-cyclical buffer in stressed markets.

We welcome the subsequent paragraphs distinguishing between insurers as a source of financing and insurers as a receiver of financing. If an insurer who had invested in a bond of another institution were to fail this would have limited or no adverse impact on the institution, there would just be a different creditor.

Paragraph 87

As the report notes there is considerably less interconnections within the insurance sector in comparison with the banking sector. It is important to note that not only are there less interconnections but connections are mostly linear and hierarchical and thus there is no network-like inter-insurance market similar to the interbank market. Or as the IAIS noted in its 'Insurance and Financial Stability' *"the (re)insurance sector has built in circuit breaks"* and *"connections between reinsurers are weak and most likely immaterial"*. Therefore, the failure of a primary insurer would not spread to other primary insurers via its reinsurer or indirectly to other reinsurers. Similarly, the failure of a reinsurer would not spread to reinsurers. This point is usefully illustrated in the diagram below.

Figure 21: The hierarchical structure of the (re)insurance market



Source: FINMA / IAIS

Paragraph 88:

We agree with the Group of Thirty's well researched report. Reinsurance is indeed not a source of systemic risk and in fact it helps mitigate systemic risk, as independent research from the IAIS and the Geneva Association has also confirmed.

Paragraph 89:

GFIA believes that this paragraph should be deleted. It is appropriate that the pricing of insurance and reinsurance responds to increased risk as was the case in the trade credit reinsurance example provided in this paragraph. If prices of insurance and reinsurance had not increased with heightened risk during the crisis, solvency risk would have been generated in the industry. In our opinion, the reinsurance market responded appropriately by increasing the cost of reinsurance for the increased risk of trade receivables defaults in the wake of the crisis and the recession that it caused.

The example cited regarding trade credit insurance is not applicable to the systemic risk characteristics of reinsurance. Prior to and during the crisis, trade credit insurance was concentrated among three major insurers. It was the concentration among these primary insurers and not the lack of capacity or risks concentrated in the reinsurance market that caused the relatively brief and very temporary reduction in capacity in this line. In this regard, we believe effective oversight aiming to prevent excessive concentration in the market plays an important role.

It is worth noting that insurance and reinsurance capacity was plentiful during the crisis and has continued to increase much more rapidly than the global economic recovery. Consequently, we suggest deleting this paragraph, as changes in the pricing of risk do not constitute a source of systemic risk.

Paragraph 90:

GFIA supports the conclusion that interconnectedness among (re) insurers is qualitatively different than within the banking sector.

However, a more developed reasoning, ideally backed up by references, is needed for the statement: *"Natural disasters are another important source of systemic insurance risk, at least at the national level"*.

Paragraph 96

"The scope and diversity of risks covered by the insurance sector suggests that the collapse of the sector or any major player(s) within the sector might have material economic and social repercussions."

This statement does not differentiate between the 'insurance sector' as a whole and 'major player(s) within the sector'. This is a key differentiation. The fact that collapse of the sector as whole (a highly unlikely scenario) might have material economic and social repercussions does not mean that the collapse of individual institutions would have a similar effect.

Paragraph 99 and in general

Interconnectedness in insurance and reinsurance is qualitatively different from banking because of the very big differences in business models. In particular, insurance obligations, unlike short-term bank obligations, are not liquid and settle over a very long period of time. Underwriting risks are generally not correlated with other financial risk. This characteristic allows the insurance and reinsurance industry much more time to respond to exogenous financial market events and settle their obligations with insurance and other financial counterparties in accordance with the contract terms even under crisis conditions.

Yours Sincerely

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