



# CHALLENGES IN ADDRESSING POTENTIAL SYSTEMIC RISK IN INSURANCE

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# Reflections on the systemic regulatory framework and process

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**The FSB seeks to control systemic risk in “non-traditional” insurance activities of companies identified as “systemically important” through a capital surcharge**

## **Open issues:**

1. The designation methodology of systemic companies is not stabilised
2. Size is penalized while it is a factor of stabilization in insurance
3. The “systemic risks” to be addressed are not identified
4. The concept of “non-traditional” insurance is not defined
5. The capital proposal is volatile and procyclical



# Risk management as of today: European perspective

## Solvency II

- Capital based on a stress scenario to withstand 1/200 year shock
- Risks covered:
  - Market risks incl. *Equity risk, Credit risk, Currency risk, Spread risk*
  - Counterparty default risk
  - Life risks: *Longevity risk, Mortality risk, Morbidity risk, Lapse risk*
  - Non-life risks incl. *Natural catastrophe risk*
  - Health risks incl. *Epidemic risk*
  - Operational risk

Includes: diversification, volatility adjustment, matching adjustment, long-term exposure

***plus:***

**Group supervision**

**Systemic Risk Mgmt Plan**

**Liquidity Risk Mgmt Plan**

**Resolution Plan**

**Recovery Plan**

# What the FSB proposes

## → “Basic capital requirement” (BCR) established by the FSB in 2014

$$BCR = \alpha [ cap_a(trad. life) + cap_b(trad. non-life) + cap_c(non-trad.) + cap_d(assets) ] + cap_n(non-insurance)$$

## → Proposed capital surcharge (Higher loss absorbency – HLA) formula:

$$HLA = \alpha \beta [ \gamma BCR (non-trad.) + (1-\gamma) BCR (trad.) ] + \min(1\% RWA; \alpha \beta \cdot 1.33 \cdot BCR (non-insurance))$$

$\alpha$  = pre-determined factor to keep average HLA constant

$\beta$  = G-SII scoring factor

$\gamma$  = weighting factor

## → A capital surcharge based on the whole balance sheet

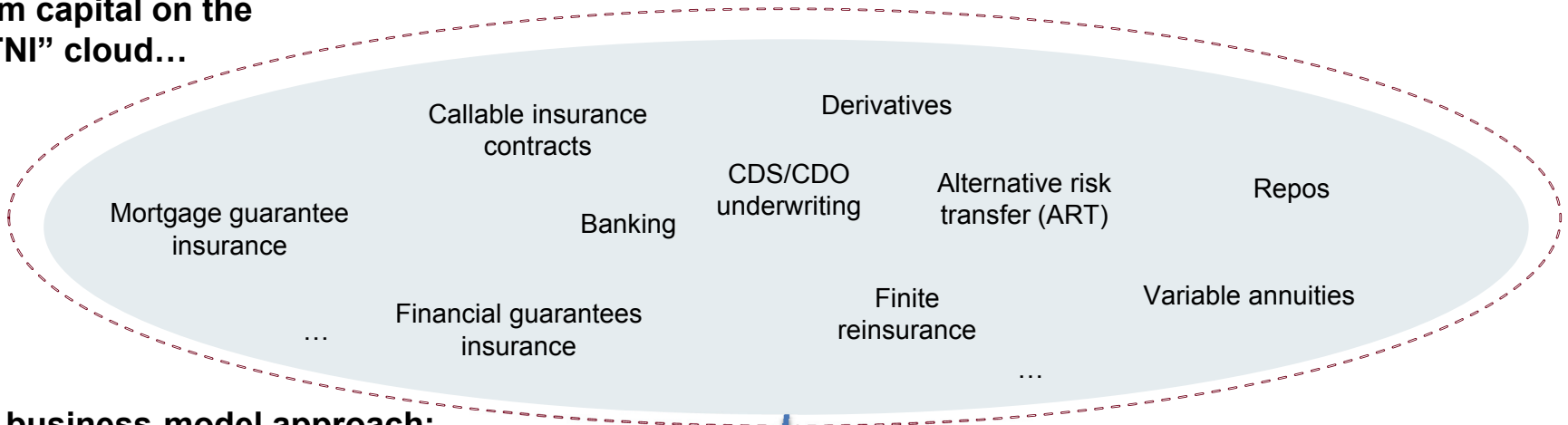
- “Core-insurance activities are not sources of systemic risk” (IAIS, 2011)
- Diversification not considered
- Asset Liability Management not considered and volatility adjustment missing

## → Consequences:

- A second and parallel capital-framework – two different compasses!
- Financial (in)stability?
- An unnecessary build-up of idle capital

# An alternative proposal

From capital on the "NTNI" cloud...



...to a business-model approach:



Systemic risk control through:

