06.

EIOPA's macroprudential work

EIOPA Insurance and Reinsurance Stakeholder Group meeting
Frankfurt, 4 April 2018

Introduction

- Why is the topic on the agenda?
  - The topic is becoming very important in insurance
  - Comes back to a previous request of the IRSG

- What is expected from the IRSG?
  - Take note and exchange views on the topic

- Next steps
  - EIOPA will continue working on all remaining aspects

Background

- Extensive discussion in the banking sector. Debate slowly spreading over to insurance
  - ✓ The debate is useful and necessary
  - ✓ Need to ensure that it takes into account insurance specific features
  - ✓ Not much work (research, policy papers, etc.) available
- A Project Group (PG) was set up under the Risks and Financial Stability Committee (end 2016)
  - ➢ Main objective: to develop an EIOPA policy stance on all relevant aspects around macroprudential policy in insurance
  - ➢ Issues around Ultimate Forward Rate and standard formula are out of scope
- Deliverables:
  - ➢ Short-term deliverable: EIOPA stance on all relevant aspects
  - ➢ Long-term deliverable: Solvency II review

PG Macroprudential Policy in Insurance – Overall approach

1) Does insurance create or amplify systemic risk?

Topic 1 : Systemic risk and macroprudential policy in insurance

- **Published**: https://eiopa.europa.eu/publications/reports

2) What tools are already in place?

Topic 2: Solvency II tools with macroprudential impact

- **Published**: https://eiopa.europa.eu/publications/reports

3) Are other tools needed?

Topic 3: Assessment of other potential tools

- To be discussed in Q2

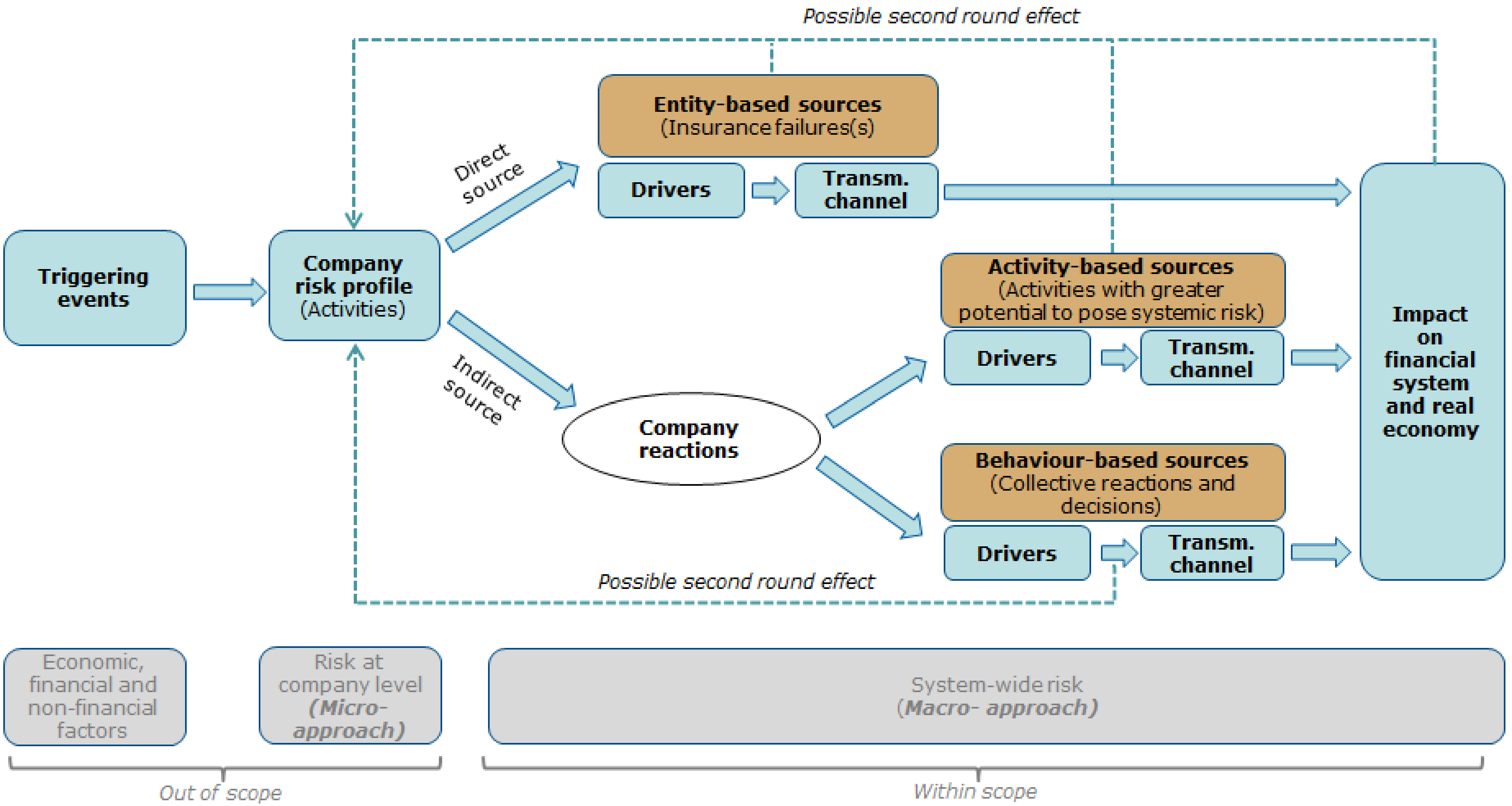
1) Does insurance create or amplify systemic risk?

- Key elements in EIOPA's conceptual approach
  - ✓ Triggering event
    - Event that has an impact on one or more companies
    - Potentially triggering the systemic risk creation process
  - ✓ Company risk profile (resulting from its activities)
    - Specific features of the company, reflecting the strategic and operational decisions taken
    - Risk factors the company is exposed to, i.e. the potential vulnerabilities of the company
  - ✓ Systemic risk drivers
    - Elements that may turn a company specific-stress into a system wide stress

1) Does insurance create or amplify systemic risk?

- Key elements in EIOPA's conceptual approach [cont.]
  - ✓ Transmission channels
    - Exposure channel
    - Asset liquidation channel
    - Lack of supply of insurance products
    - Bank-like channel
    - Expectations and information asymmetries
  - ✓ Sources of systemic risk
    - Results from (a) Systemic risk drivers; and (b) Transmission channels
    - EIOPA considers three: Entity-, Activity- and Behaviour sources
- What are the dynamics by which systemic risk in insurance can be created or amplified? *-> See next slide*

1) Does insurance create or amplify systemic risk?



1) Does insurance create or amplify systemic risk?

<table>
<tr><th></th><th>Sources of systemic risk</th><th>Operational objectives</th></tr>
<tr><td>Entity-based sources</td><td>➢ Deterioration of the solvency position leading to:
• Failure of a G-SII, D-SII
• Collective failures of non-systemically important institutions as a result of exposures to common shocks</td><td rowspan="3">➢ Ensure sufficient loss-absorbency capacity and reserving
➢ Discourage excessive involvement in certain products and activities
➢ Discourage excessive levels of direct and indirect exposure concentrations
➢ Limit procyclicality
➢ Discourage risky behaviour</td></tr>
<tr><td>Activity-based sources</td><td>➢ Involvement in certain activities or products with greater potential to pose systemic risk
➢ Potentially dangerous interconnections</td></tr>
<tr><td>Behaviour-based sources</td><td>➢ Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour)
➢ Excessive risk-taking by insurance companies (e.g. ‘search for yield’ and the ‘too-big-too fail’ problem)
➢ Excessive concentrations
➢ Inappropriate exposures on the liabilities side (e.g. as a result of competitive dynamics)</td></tr>
</table>

2) What tools are already in place?

- Solvency II is in itself designed to ensure sufficient loss absorbency capacity and reserving
- There are, however, specific tools with macroprudential impact(*) – Steps followed:
  1. Identification of the main instruments with macroprudential impact
     - Symmetric adjustment to the equity risk sub-module
     - Volatility adjustment
     - Matching adjustment
     - Extension of the recovery period
     - Transitional measure on technical provisions
     - Prohibit or restrict certain types of financial activities

       -> This tool is not within Solvency II, but is inline with its spirit and scope

(*) It should be noted that Solvency II has other elements with *indirect* macroprudential impact that should not be ignored (prudent person principle, the own risk and solvency assessment and the capital add-on under specific circumstances)

2) What tools are already in place?

2. Classification and mapping of instruments

Tools	Sources of systemic risk	Operational objectives
➢ Symmetric adjustment ➢ Volatility adjustment ➢ Matching adjustment ➢ Extension of the RP ➢ Transitional measure on TP	• Collective behaviour by insurers that may exacerbate market price movements	• Limit procyclicality
➢ Prohibit or restrict certain types of financial activities	• Involvement in certain activities or products with greater potential to pose systemic risk • Excessive risk-taking by insurance companies	• Discouraging excessive involvement in certain products and activities • Discourage risky behaviours

3. Initial/preliminary assessment of the macroprudential impact

- ➢ Although the tools may have limitations from a macroprudential perspective, they seem to work effectively
- ➢ Given, however, that not all the sources of systemic risks are covered, <u>there is room for potential new instruments</u>

3) Are other tools are needed?

Work in progress

- Assessment of other potential tools – Steps:
  - ✓ Identification of potential new instruments/measures
  - ✓ Description of each tool and maps them with sources of systemic risk identified
  - ✓ Consideration of the interaction of instruments with Solvency II
  - ✓ Preliminary analysis and conclusion
- Issues for consideration:
  - ➢ Enhanced monitoring vs. stronger intervention tools and measures
  - ➢ Challenges ahead
  - ➢ Next steps