

Counter-cyclical measures in insurance

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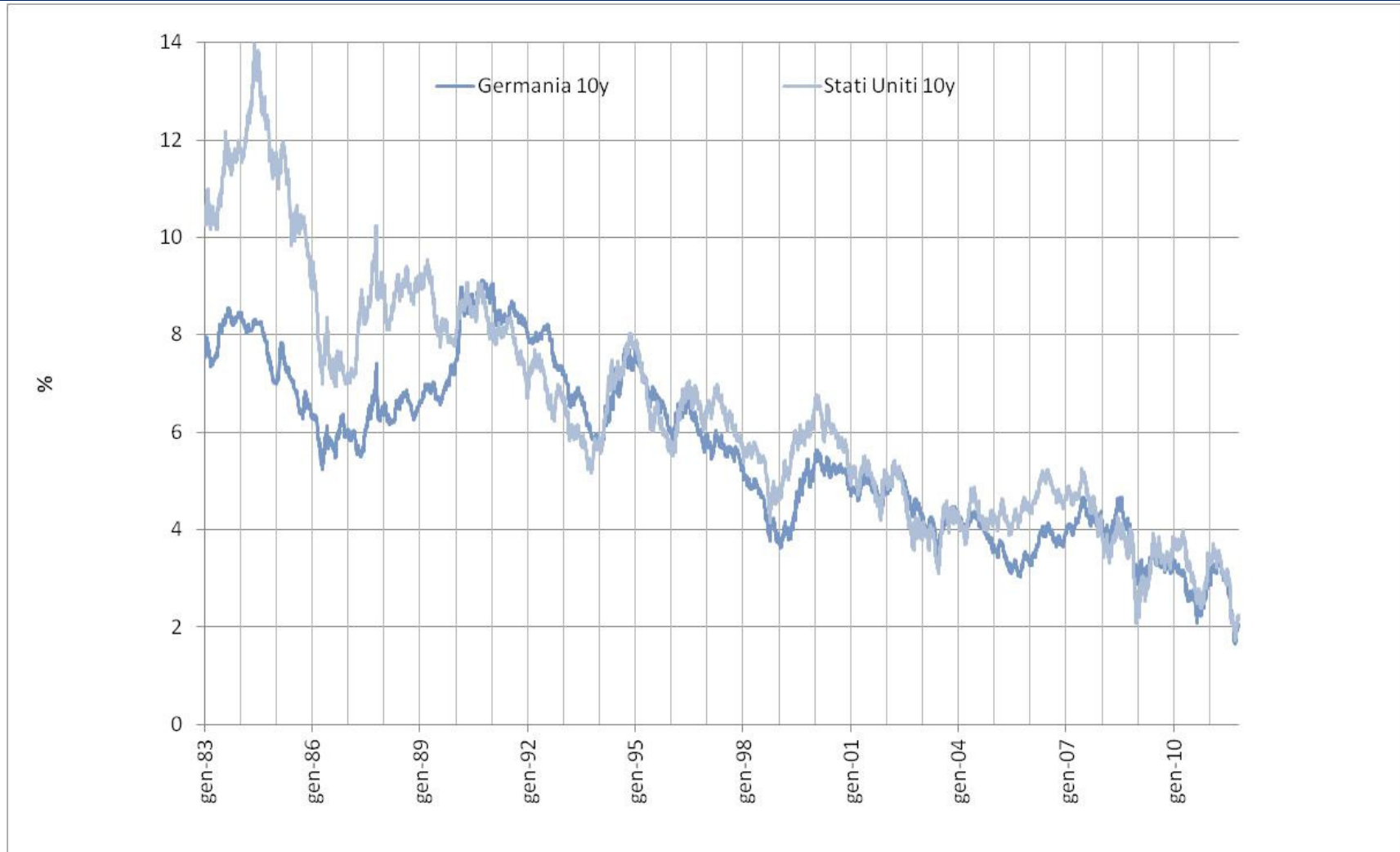
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(*) The view and opinions represent my own and do not necessarily reflect those of institutions or organizations I am affiliated with unless stated explicitly

Do we need something different ?

- We discovered during such turbulent years that there is another powerful source of procyclicality: the “risk free interest rate”
 - Namely, the rate used to calculate L
- One problem is that yields on AAA sovereign bonds seem to be persistently low, possibly given a worldwide shortage of safe assets (Bernanke, Caballero among others)
 - In order to hedge the exposure to fluctuations on the asset value, insurance companies might buy only AAA assets thus exacerbating the problem

Do we need something different ?

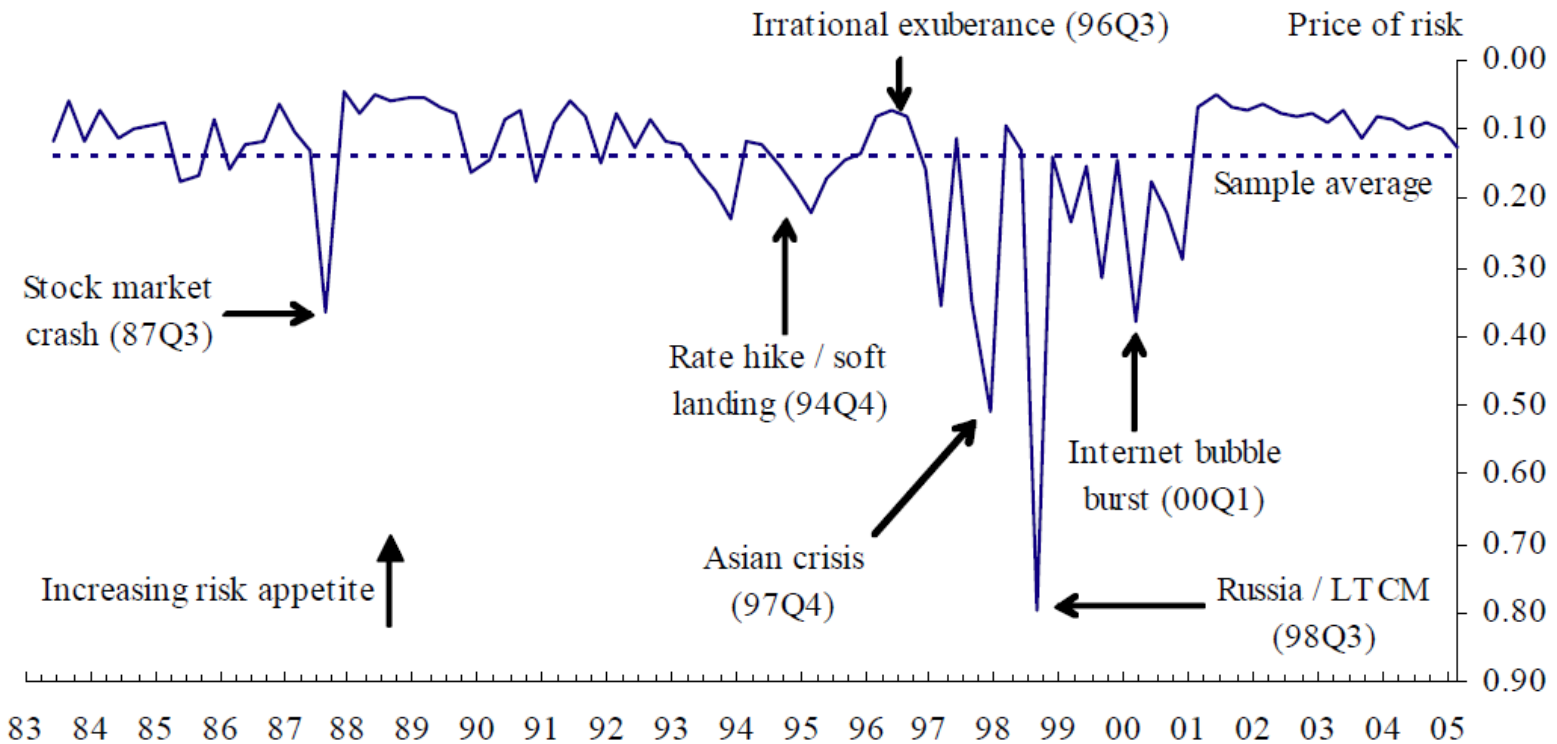


Do we need something different ?

- The other problem (possibly more important) is that we observe large swings in the market risk aversion
- In other words, The appetite for risk varies through the cycle
 - Thus, changes in the differentials between the risk free rate (used for calculating L) and other rates (used for calculating A) directly modify K
 - The problem is aggravated by the maturity transformation (duration mismatch). Given the very long term nature of certain insurance liabilities, it may be difficult to find assets carrying a similar duration and extreme volatility is more severe as duration gets longer

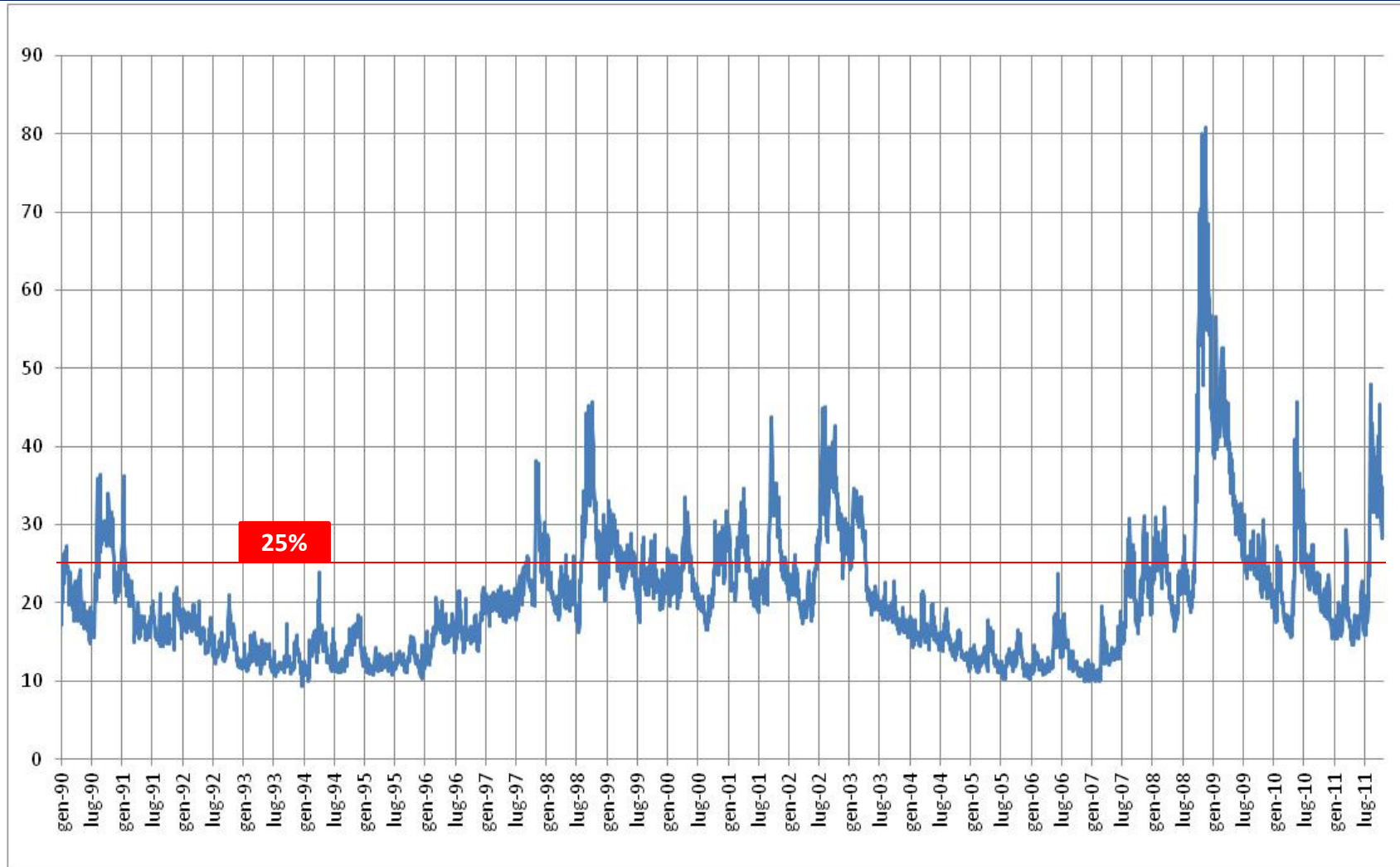
Risk appetite

Chart 3: Estimated risk appetite



Measuring investors' risk appetite Gai and Vause, Bank of England Working Paper no. 283 (2005)

CBOE SPX VOLATILITY - VIX



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Conference on Reform of Financial Regulation
Lisbon 28.10.2011

The proposed adjustments

