Insurance Risk Management Response to the Financial Crisis

April 2009

CRO FORUM

Table of Contents

Executive Summary 5

Integrated risk governance 7

Risk models 10

Liquidity management 12

Valuation and risk disclosure 14

Group supervision 17

Executive summary

The current financial crisis makes abundantly clear the importance for (re)insurance companies of pre-emptive and independent risk management. This task poses demands at every level: individual companies, global groups, regulators, governments, rating agencies, and international institutions.

Regulators and governments in many countries have launched initiatives to bolster financial stability and restore market confidence. As part of this effort – and recognising that they themselves had not adequately appreciated the risks building up in the financial system – most are reviewing their regulatory regimes to help identify and avert future crises. It is crucial for the insurance industry that regulators and governments succeed in their battle to restart the world's financial markets. Success will require international cooperation and coordination, with group-level supervision and efficient capital management for global (re)insurance groups. Any new regulation will need to take account of the insurance industry's distinct business model; it should avoid creating market distortions and offer clear incentives for sound risk and capital management.

This paper summarises the CRO Forum's views on the key elements of effective risk management, the differences between insurance and banks' approaches to risk management, and the importance of economic-based group supervision for cross-border (re)insurers. It covers five major themes which the CRO Forum considers to be adequate responses to the crisis. They have proved to work effectively for those (re)insurance companies that have rigorously followed these principles and they should form the basis for any conclusion to be drawn as lessons learned from the crisis:

Integrated risk governance
(Re)insurers rely on sound and comprehensive internal risk governance to respond effectively to changing market conditions. The risk management function needs to be pre-emptive, independent and empowered. This will foster a genuinely risk-aware culture in each organisation, by clearly articulating and monitoring the company's risk tolerance. Also compensation should be based on risk-adjusted performance, and is therefore an essential part of an integrated risk management regime.

Risk models
These are indispensable tools for developing business, designing and managing products, valuing portfolios, gauging capital adequacy and increasingly used for regulatory purposes. Although their capabilities are numerous, they can never be a substitute for common sense as they do have significant inherent limitations. Risk models require regular improvement in the light of experience and need the complement of sound management judgment to be effective.

Liquidity risk management
The credit crisis is a sharp reminder of liquidity risk as distinct from risk to capital adequacy. Liquidity risk management has to prepare for the unexpected and thus relies on scenario testing to anticipate the effects of extreme situations. However, it is important to note that liquidity risk of insurers is fundamentally different from that of banks.

Valuation and risk disclosure
Renewed market confidence requires accurate valuation and the prompt disclosure of relevant risk information. Market-consistent valuation of both assets and liabilities should become the principle that underpins financial information and prudential oversight in insurance. Properly applied, these would not aggravate pro-cyclicality. Rating agencies played an important role in the financial crisis. They should be brought under supervision, however the use of ratings in financial regulation should be curtailed.

Group supervision
The financial crisis emphasises the need for international cooperation among regulators to develop group-level supervision, particularly through results-oriented supervisory colleges for large and global insurance groups. The CRO Forum supports a principle and economic risk-based approach for the supervision of groups, which assesses their consolidated risk exposure and capital position in line with economic reality. The efforts of the International Association of Insurance Supervisors (IAIS) should be strengthened by introducing binding standards that would accelerate regulatory convergence.

Integrated risk governance

(Re)insurers rely on sound and comprehensive internal risk governance to respond effectively to changing market conditions. The risk management function needs to be pre-emptive, independent and empowered. This will foster a genuinely risk-aware culture in each organisation, by clearly articulating and monitoring the company's risk tolerance. Also compensation should be based on risk-adjusted performance, and is therefore an essential part of an integrated risk management regime.

A comprehensive view

Integrated risk management must be more than the sum of its parts. Every insurance company is exposed to a wide range of risks, some discrete and some interdependent. The "silo view" from a single business category or geographical base can easily miss the potential for cumulative risk; only a comprehensive, group-wide view can support a robust yet responsive risk management regime. Integrated risk management entails strong governance processes, ensuring greater accountability, transparency, and risk awareness in underwriting, investment and strategic decisions. New business products and services should undergo stringent approval processes that examine not only the specific risks taken on but also the models and assumptions by which these risks were assessed. Integrated risk management should never be a static "check the box" exercise. It is a dynamic process that allows companies to identify emerging or intensifying risks quickly, assess whether they are correlated with other risks and adjust their strategies and practices to meet them.

Independent, empowered, effective

Because the insurance industry profits by taking on risk, there is always the potential for conflicting priorities in writing business. Risk management should therefore be a function independent from profit-and-loss responsibility, but closely aligned with the company's strategy. Risk management needs both to review the strategy of a company and to assess the risks associated with it.

The Board of Directors must take ultimate responsibility for supervising a company's risk management framework, as well as approving and supervising its overall risk tolerance. The Risk Management function then monitors all risk takers (the individual business units, their sales forces and underwriters) in their execution of the Board's risk mandate – while Internal Audit provides the Board and senior executives with independent scrutiny of business practices and governance.

The Chief Risk Officer must, therefore, be given a powerful role in the organisation, with an equal seat at its highest level of executive management and direct access to the Board or the Board's dedicated Risk Committee. This is essential both to maintain a comprehensive view of the company's risk landscape and to help establish a strong risk culture throughout the company, from the top down.

An effective risk culture demands clear articulation and internal communication of the company's risk tolerance in key areas: capital adequacy, earnings stability, liquidity and reputation. Risk tolerance is best expressed in regularly-monitored risk limits. Business development needs to be managed against these limits in a forward looking way, anticipating where limits may be breached and identifying remedial actions to avoid undesirable excess exposure.

Making compensation the solution, not the problem

The financial crisis has generated a great deal of discussion about executive compensation and whether pay and bonus schemes encouraged the flawed practices that led to the current problems. In the CRO Forum's view, the principle of performance-based compensation is a sound one; but, as with all principles, the challenge is to apply it properly. Performance-based schemes can be a powerful tool to align the interests of employees, shareholders and policyholders; they can also concentrate employee attention on risk issues and help foster a strong risk culture. On the other hand, artificially constraining overall levels of management compensation, as some are now advocating, could result in providing wrong incentives and even eroding shareholder value.

The key to making incentives work is to ensure that they correspond with the financial health and evolution of the whole business. They should not reward excessive short-term returns, but should reflect risk-adjusted performance and long-term, group-wide sustainable profitability. Elements of deferred compensation are particularly appropriate for the insurance industry – and particularly in life insurance – where risks remain on the balance sheet for several years, during which they may develop in ways that were not anticipated when they were taken on. By contrast, compensation based solely on volume of sales is inappropriate for insurance, because it does not take account of risk/return relationships. In general, the CRO Forum believes that compensation is an essential part of an integrated risk management regime: by providing incentives for favourable risk-adjusted performance, it helps align the long-term interests of employer and employee and policyholders.

Internal risk governance: rules-based or principles-based?

The current crisis has exposed some basic shortcomings in the insurance regulatory regime, but also highlighted the importance of a principles-based approach. Traditional rules-based regulation tends to foster a culture of blind compliance rather than risk awareness. Differences in rules between jurisdictions can also tempt companies to indulge in regulatory arbitrage, which in turn hinders efforts toward greater industry transparency and creates the risk of future instability and further crises.

The CRO Forum therefore supports the move to principles-based economic regulation, which encourages stability by enforcing consistent principles across jurisdictions and creates incentives for stringent governance and sound internal
controls. One example of principles-based regulation is the European Union's planned Solvency II regime; this clearly puts the responsibility for identifying, assessing and managing risk exposure onto the insurance companies. After all, regulators' best line of defence against insolvency is to have strong risk management within companies. This trends reflects the advances made in enterprise risk management since the crisis of 2000–2003 and allows companies to cope flexibly with new risks, product structures or business conditions. Similar supervisory frameworks – the Swiss Solvency Test (SST) in Switzerland and the Individual Capital Adequacy System (ICAS) regime in the UK – have already provided a positive experience.

Risk models

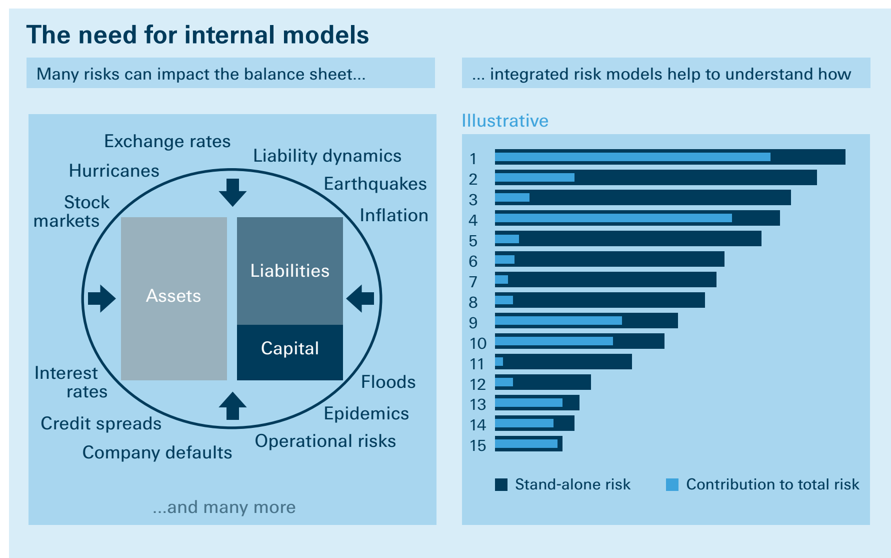
Risk models are indispensable tools for developing business, designing and managing products, valuing portfolios, gauging capital adequacy and are increasingly used for regulatory purposes. Risk models need to be embedded in the risk governance framework and not developed in isolation. Although their capabilities are numerous, they can never be a substitute for common sense as they do have significant inherent limitations. Risk models require regular improvement in the light of experience and need the complement of sound management judgment to be effective.

Risk models: essential tools
All large European insurance and reinsurance groups have developed integrated internal risk models to help allocate risk-taking capacity to different lines of business and determine the level of capital necessary to support their operations. Regulators are also increasingly referring to these models when asking companies to assess their regulatory capital requirements. The models help companies, amongst others, maintain effective asset-liability management (ALM), which monitors the net impact of risk on the future value of assets and liabilities. They also provide a comprehensive view, recognising that a single risk can affect several sub-portfolios through mutual dependencies.

Risk management without risk modelling is not an option: the complexity of the insurance business model requires sophisticated techniques to measure and manage risk exposures. This is not an industry where simplification improves understanding. In fact, risk modelling has served the business remarkably well. The long-term perspective required to manage a risk profile has been accurately reflected in the models; and even extreme recent events had been anticipated as remote but definitely possible occurrences.

The same holds true for regulation: supervising a (re)insurance company without building on risk modelling is not an option either. Supervisors should be able to refer to the most appropriate modelling techniques available within a (re)insurance company, benefiting from continuous improvements, rather than being bound to simplistic regulatory approaches.

The need for internal models



No model is ever perfect

Despite their necessity, internal models can not capture or accurately reflect all risks equally well. Certain financial situations can result in unprecedented events: for example, models were insufficiently sensitive to the risk from exposure to structured credit – but then, the simpler regulatory models also underestimated these risks.

The crisis has reaffirmed, not that models are flawed, but that they need continuous improvement to retain their effectiveness. Companies should take the lessons of extreme situations and incorporate them into further design and calibration. For instance, the crisis has revealed that certain diversification effects did not work as expected, especially for financial market exposures and their related "tail dependencies," or likelihoods of simultaneous occurrence of extreme events. On the other hand, other diversification effects for insurance risks did indeed behave as the models predicted – a major reason why insurance companies are in comparatively better condition than are banks. The risk diversification concept, like the other concepts underpinning economic capital models, remains sound – but some parameters and dependency assumptions will need to be reviewed.

Another lesson of the crisis is the usefulness of scenarios to supplement modelling. Models based on historical data, even in long time series, may not be enough to understand extreme situations. Insurance companies will need to further elaborate their scenario and stress testing – exploring points where diversification effects break down, new risk concentrations arise, or risk-reinforcing feedback loops form. These separate analyses complement and support the integrated risk model, and also feed the regulatory debate.

Risk model and risk judgement: two sides to the coin

Risk models are intended to be used as part of the decision process, not to replace it. The CRO Forum strongly supports risk models as indispensable aids to managing insurance business and assessing solvency capital required, but believes equally strongly that models should be complemented with internal controls, such as risk concentration limits, and stress and scenario testing. They need to be paired with sound management judgment: there is no substitute for a deep understanding of risk, nor for common sense.

Managers need to understand the limitations of risk models and to be aware of when to use them and when to rely more on judgment. This makes the development and use of models a matter of internal governance, in which internal stakeholders, such as executive management or the Board, are likely to become more involved. The governance structure will need to assure that risk models are designed and calibrated independently from the risk-taking function, that they are subject to independent expert review and that the processes are subject to adequate control to ensure the models are applied correctly. These considerations are equally important for regulators when introducing solvency regimes that allow (re)insurance companies to use their internal models to calculate their regulatory capital requirements.

Liquidity management

The credit crisis is a sharp reminder of liquidity risk as distinct from risk to capital adequacy. Liquidity risk management has to prepare for the unexpected and thus relies on scenario testing to anticipate the effects of extreme situations. However, it is important to note that liquidity risk of insurers is fundamentally different from that of banks.

Liquidity risk and capital adequacy

Liquidity risk is the measure of probability that a company's cash resources will be insufficient to meet current or future cash needs. Improperly managed liquidity risk has been a major contributor to corporate distress in the financial services industry, both in the past and in the present crisis. A clear understanding of cash sources and cash needs is essential for effective liquidity risk management. In response to the crisis, insurance companies have enhanced their monitoring of these factors; it is therefore appropriate to discuss how liquidity risk management fits into the larger task of an enterprise-wide risk management framework.

Liquidity is not the same as capital

Compared with risks affecting the capital position of an insurance company, liquidity needs are sudden: they often arise over a shorter interval than the one-year period typically used to assess capital adequacy. Valuable capital assets can become illiquid. Holding sufficient capital, therefore, does not guarantee sufficient funding liquidity, nor does additional capital necessarily translate into additional funding liquidity. It is imprudent to expect any amount of capital to protect a company against the possibility of financial distress arising from liquidity risk; (re)insurers have therefore developed robust liquidity risk management programs as part of their broad enterprise risk management framework.

Insurance is not the same as banking

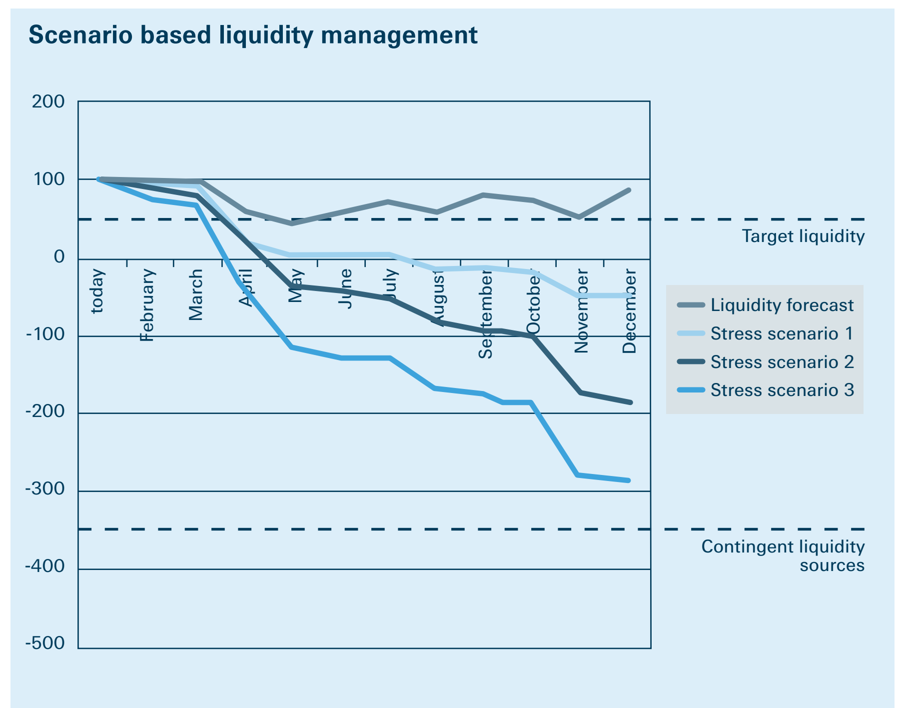
The insurance business model makes insurance companies inherently less exposed to liquidity risk than are banks. Insurers do not rely on short-term funding. Their production cycle works inversely to the banking cycle, since they are funded through up-front advance premium payments – rather than in arrears through debt interest payments – and typically do not use leverage to enhance expected investment returns. Moreover, policyholders usually cannot withdraw money from insurance companies at will or only at high cost. For (re)insurers, the critical measure is the ability to pay claims and meet policyholders withdrawals when they are due. It is therefore important that the regulatory regimes for insurance and banking remain differentiated in their approach to liquidity risk to reflect the essential, structural difference in their business models.

Planning for the unforeseen

The CRO Forum believes that liquidity risk requires active management in normal operating environments as much as under extreme conditions. The best line of defence is a robust, explicit liquidity policy and framework that accurately measures, monitors, and manages liquidity risk. This framework should include an operational plan to help the company through liquidity stress conditions, including expected funding gaps and time intervals. The appropriate internal parties should review and approve its main assumptions and parameters. The company and the industry should maintain clear reporting and dialogue on liquidity risks with regulators.

Because insurance is exposed to lower liquidity risk in normal conditions, companies should recognise that their greatest exposure to it is likely to be at times of general extreme financial stress. Therefore, the best way to assess liquidity risk is through liquidity stress tests that are conducted and reviewed on a regular basis, and take account of the specific characteristics of each company – its assets and liabilities, policyholder servicing and distribution – as well as the state of the insurance and capital markets in which it operates.

As every company has its own unique liquidity risk, so stress testing must be as specific to the individual situation as possible. For example, a company will usually have established prior access to contingent liquidity sources, internal or external, to help it manage during extreme liquidity risk events. It is essential, though, to ensure that such sources will actually be available in a given scenario – when a liquidity crisis overlaps with a credit crisis, for instance, it may not be possible to attempt to boost liquidity by issuing additional debt or by selling volumes of assets in a short period at fair prices.



Valuation and risk disclosure

Renewed market confidence requires accurate valuation and the prompt disclosure of relevant risk information. Market-consistent valuation of both assets and liabilities should become the principle that underpins financial information and prudential oversight in insurance. Properly applied, these would not aggravate pro-cyclicality. Rating agencies played an important role at various stages of the financial crisis. They should be brought under supervision however the use of ratings in financial regulation should be curtailed.

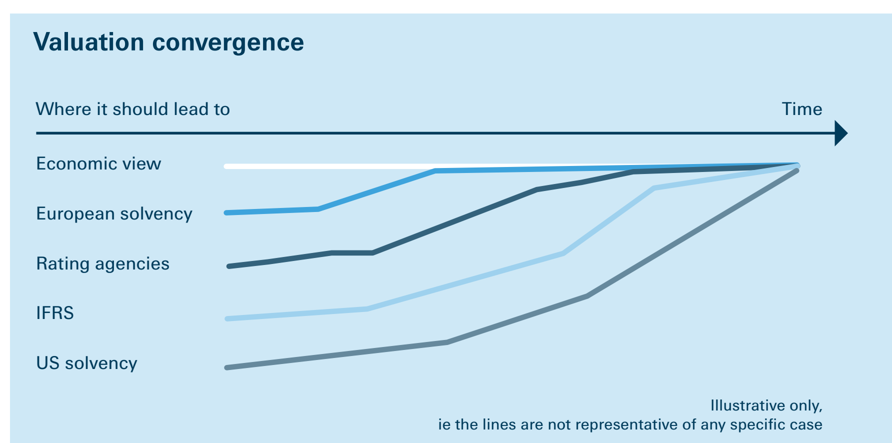
Market-consistent valuation: what it is and what it is not

The valuation of assets and liabilities is the essential measure of any enterprise. The challenge to accurate valuation, though, is illiquidity, particularly when, as is the case now, markets in certain asset and liability classes have essentially closed down. Moreover, insurance liabilities are not usually traded in liquid markets, but are fulfilled over the lifetime of a policy.

This is the reason why many insurers and reinsurers base their risk frameworks on market-consistent valuation. Market consistent valuation means that components of the insurance liabilities that can be replicated in liquid financial markets are valued at market values, and the components which cannot be replicated are marked to model. As market parameters in a given market – such as interest rates, volatility, liquidity and risk premiums – vary over time, valuation adjusts accordingly. The same approach can be applied to value assets. The process is dynamic, allowing for an accurate economic valuation in the full range of market conditions.

One way in which market-consistent valuation of insurance liabilities differs essentially from traditional valuation practice is that it aims for a genuinely economic valuation of technical liabilities: it does not contain additional margins for prudence.

Market-consistent valuation has proven its worth in the current crisis through its combination of flexibility and robustness. However, it is not an automatic process; instead it depends on rigorous controls and deep expertise. The valuation of complex or illiquid securities must also be completely independent, requiring a clear internal risk governance structure.



Dealing with pro-cyclicality

The best defence against pro-cyclicality is to apply an objective and consistent measure of risk that takes into account extreme shifts in the risk environment. In addition, risk calibration and assessment must not only be based on past experience but also on plausible scenarios for the future. Companies should have risk limits in place that ensure an appropriate balance of risk – even if this means taking much less risk than the model allows. A proper balance of risk must also reflect the tail interdependencies of risks – not just their average interdependency.

This approach – managing tail concentrations and maintaining a market-consistent valuation of risk exposure – provides an early-warning system that will allow the company to reduce risk gradually, if desired. It also ensures that the company's exposure remains balanced and is thus manageable even in extreme environments.

Regulatory frameworks that are not market-consistent create dangerous incentives and establish a false sense of security as to how much risk the company can afford to take. One example of this is a regulatory framework that allows bonds to be carried at amortised cost and sets capital-based credit ratings. A company that assesses its risk appetite on this basis will overweight its bond exposure, as the regulatory framework does not recognise the loss when bonds fall in value. Instead, such regulatory framework actually creates a disincentive for the company to reduce its risk by selling bonds, due to the large cumulative impact on regulatory solvency: in market stresses, the ratings on these bonds will start falling, thus raising capital requirements in large steps for each downgrade.

Even under a fully economic approach to risk and regulation, pro-cyclicality can arise in extreme market environments where capital markets are impaired. This liquidity risk cannot be managed by economic models, as it may be driven by multiple factors. When it does occur, regulatory intervention must be flexible, so that companies are not forced to reduce risks where exposures are illiquid. Forced risk reduction in an illiquid market could drive down prices even further and make the situation worse.

In summary, a trustworthy valuation regime requires consistent information and clear methods of interpretation. Changing accounting rules in order to mitigate pro-cyclical valuation effects may provide misleading information to investors and policyholders – and potentially even erode incentives for better risk management among insurers. Furthermore, excessive "quick-fix" changes in international accounting standards will damage the market's confidence in those standards.

Pro-cyclicality and capital risk charges

Consistent application of capital risk charges to all sources of risk is imperative in any risk-based solvency calculation: inconsistent application would create perverse incentives for certain asset classes or risks which would then be reflected in insurance products. These excesses increase pro-cyclical risk. At the same time, it is important for any solvency regime to address the pro-cyclical effects of capital risk charges. Forced sales of assets or hedge positions in illiquid markets should not be imposed by the regulator. Reduced available capital due to distressed asset prices within an impaired liquidity environment should also not require immediate regulatory intervention.

In general, the CRO Forum sees the need for measures to address pro-cyclicality, but is hesitant to do so by introducing counter-cyclical features into the solvency margin calculation.

Providing useful transparency

The CRO Forum strongly encourages transparent disclosure of the methods and results of companies' valuation processes. It also supports consistent principles-based financial reporting, which will help to restore the confidence of market participants and contribute to market discipline. Furthermore, comprehensive, transparent and frequent internal risk reporting to senior management, backed by robust processes and IT systems, is an essential pre-requisite for effective risk management.

Insurance-linked securities (ILS) provide a good example of a market in need of greater transparency. ILS can be an effective tool for transferring peak and volume risks to the capital markets. Unlike banks, insurers usually keep a significant amount of the risk they securitise: they do not re-package their entire exposure. Unfortunately, the securitisation market as a whole has suffered a complete evaporation of trust. The first step toward reviving it is increased transparency: comprehensive, consistent, easily accessible disclosure, standardised contracts and reporting and stringent rating guidelines.

Who rates the ratings?

There is a widely-held view in the market who claim that the credit rating agencies are partly responsible for the current crisis because they did not provide a full assessment of the risks embedded in structured products. Regulators appear to share this view: they have requested that the rating agencies comply with a tightened code of conduct set by the International Organisation of Securities Commissions (IOSCO) to prevent conflicts of interest and improve disclosure to investors and issuers. The EU and US are introducing even more stringent requirements.

The CRO Forum recognises that third-party measurement of default probabilities is still a necessary function, but believes that there are important improvements required in the governance of rating agencies. To begin with, the agencies' income depends on the outcome of the rating process; this creates significant potential for conflict of interest. The agencies are not subject to regulation, but their ratings are used by regulators and the public as a source of validation and a factor in decision-making.

The CRO Forum supports that the rating agencies be brought under supervision and that the use of ratings in financial regulation be significantly curtailed. The two recommendations are separate: improved oversight of the agencies or enhanced independence of rating processes would still not justify further intrusion of rating-based triggers into solvency rules or regulatory requirements.

Convergence in accounting standards

The Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB), and national regulators have made a start in striving for convergence in accounting standards. They must now step up their efforts to achieve this objective.

The IASB and FASB have made also progress in, for example, agreeing amended accounting standards for determining the fair value of a financial asset when the market for that asset is inactive. The logical next step is to re-examine the standards for valuing financial assets and liabilities in illiquid or distressed markets, reviewing impairment rules and improving disclosure.

Group supervision

The financial crisis emphasises the need for international cooperation among regulators to develop group-level supervision, particularly through results-oriented supervisory colleges for large and global insurance groups. The CRO Forum supports a principle and economic risk-based approach for the supervision of groups, which assesses their consolidated risk exposure and capital position in line with economic reality. The efforts of the International Association of Insurance Supervisors (IAIS) should be strengthened by introducing binding standards that would accelerate regulatory convergence and increase the voice of insurance in international supervisory debates.

Group supervision with local expertise

Insurance regulation still largely operates at the national level, but many companies do business globally and implement group-wide integrated risk and capital management strategies. Clearly, the regulatory architecture needs to adapt to reflect this economic reality, as well as the essential differences between the insurance and banking business models.

There are good reasons for the continued growth in the number of cross-border insurance and reinsurance groups: they benefit from geographic diversification. By and large, geographically diversified entities have tended to deal more successfully with market turmoil, which specially impacted mono-line insurance companies or life insurance companies with concentrated exposure to single economies. It seems obvious that these large cross-border institutions should be supervised in their entirety, with a group-level lead supervisor coordinating local activities to avoid duplication or divergence of approach. The role of each local supervisor should be to share local expertise and ensure that the local entity is fully and properly integrated in the risk and capital management of the group.

This group supervision is the most efficient way for regulators to gain a comprehensive understanding of each group's risk profile and risk concentration. It helps avoid local protectionist responses to the global crisis (such as imposed requirements for additional capital or ring-fencing of local assets) – responses that could easily increase pro-cyclical risk. It aligns the supervisory regime to reflect the way the groups are actually managed and supports the harmonisation of standards across jurisdictions. Clear coordination of responsibilities between the group-wide supervisor and local supervisors supports the mutual recognition of the equivalence of their activities: oversight becomes unified, not fragmented.

Meanwhile, the group's compliance burden is reduced. The temptation to exploit regulatory arbitrage is removed, and group risk management gains the benefits of diversification and free movement of capital. Ultimately, this approach achieves the main goal of regulation: a more stable, transparent industry with improved protection and convenience for policyholders and other stakeholders.

Efficient capital management: an essential part of the supervisory regime
Effective group supervision enables the (re)insurance company to be more efficient in the use of resources. By recognising the commitment of groups to support subsidiaries using resources held elsewhere in the group when the need arises, the full benefits of diversification can be recognised in required capital and allowed for in the pricing of risk. At the same time, group supervision ensures that required levels of policyholder security are maintained across the group.

The ability to manage risk across borders is important. Recognition of all group resources is essential to modern risk management. Local constraints to the movement of capital can exacerbate pro-cyclical risk.

The same reasons that underpin group supervision make group support a necessity in any new solvency regime. By enhancing the capital management and investment flexibility of large cross-border companies, it allows them to pass on the full benefits of diversification. An efficient capital management structure within (re)insurance groups should offer the same level of protection to policyholders across the group, regardless of its legal structure. If, however, local supervisors were in a position to mandate local constraints to the movement of capital, this could exacerbate pro-cyclical risk.

The CRO Forum notes that the decision to introduce an effective group support regime in the EU has been postponed. In line with the de Larosière report, the CRO Forum encourages policymakers to continue the discussions and work towards an early introduction of a regime enhancing efficient capital management within groups.

Colleges of supervisors
The International Association of Insurance Supervisors (IAIS) has proposed an innovative collegial structure for supervising cross-border groups. This proposal should be promoted further in order to simplify the supervisory architecture and encourage mutual recognition of equivalence. A lead supervisor, based in the group's home country, is responsible for communication with local supervisors in its various markets. This lead supervisor is encouraged to gain a global view of the group's operations and share comprehensive information on its financial situation.

The college of supervisors itself would also communicate with the regulated group. Written memoranda of understanding between regulators should govern how the college operates, setting out clear ownership of duties and responsibilities. Regulators would obviously need to assign senior and qualified decision-making staff to these colleges; it should be possible to delegate certain supervisory tasks to smaller teams. There should also be an effective mediation mechanism in case of disagreements between supervisors.

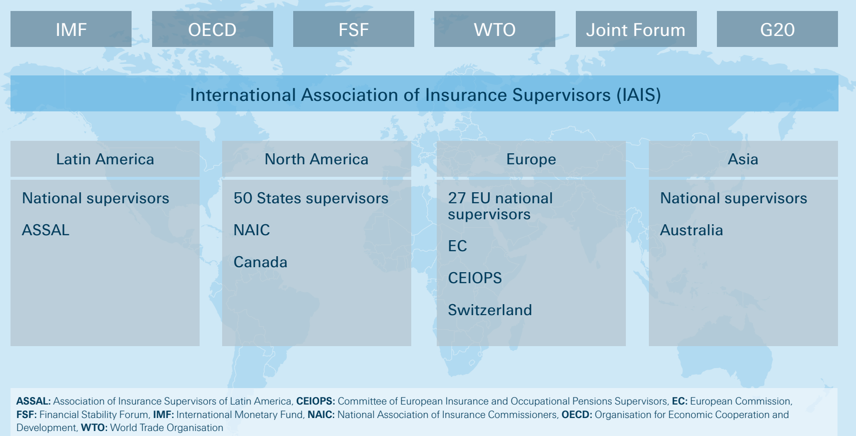
The CRO Forum supports the concept of supervisory colleges as a means to improve supervisory cooperation and coordination. Increased mutual understanding between regulators and convergence of supervisory regimes will increase the resilience of the financial system, helping to avert and mitigate future crises.

The concept of supervisory colleges needs to be coupled with an effective decision-making protocol for matters which affect the Group in its entirety. For such matters the Group supervisor should be empowered to take ultimate decisions for the case, where no consensus agreement can be reached in the college.

The crisis has demonstrated the need for common global standards and international coordination and cooperation in the supervision of insurance groups. The IAIS plays an essential role in promoting international cooperation and representing the voice of the insurance industry in international institutions such as the Financial Stability Forum (FSF) or the International Monetary Fund (IMF). To further strengthen the coordination and cooperation amongst regulators, an international body such as the IAIS should issue binding standards and decisions. Such globally binding standards would properly reflect the importance of the insurance industry in the global financial supervisory system.

Global regulatory insurance dialogue

Illustrative and non-exhaustive



ASSAL: Association of Insurance Supervisors of Latin America, **CEIOPS:** Committee of European Insurance and Occupational Pensions Supervisors, **EC:** European Commission, **FSF:** Financial Stability Forum, **IMF:** International Monetary Fund, **NAIC:** National Association of Insurance Commissioners, **OECD:** Organisation for Economic Cooperation and Development, **WTO:** World Trade Organisation

New architectures for a new economic reality

Supervision of the insurance industry needs to keep several objectives in balance: enhancing financial stability, ensuring customer protection, maintaining a level playing field for financial services, and supporting global consistency in regulation. It is clear that isolated national or protectionist responses to the current crisis are counterproductive, undermining the global functioning of financial markets, and harming the international exchange of goods and services.

One of the main obstacles to international regulatory convergence for the insurance sector is the fragmented supervisory landscape, both in the US and the EU. The CRO Forum therefore welcomes several initiatives for devising more efficient and integrated supervisory regimes:

- In the EU, the Solvency II proposals for group supervision and enhanced capital management represent a significant improvement over the current supervisory framework. By mandating transparency and cooperation among national regulators, Solvency II offers an effective answer to the challenges facing global insurance groups.
- In the US, proposed moves toward group solvency assessment will accelerate the modernisation of the state-based regulatory regime by allowing a Federal charter or a single state group supervision. This will address the current urgent need for improved oversight of insurance groups and better coordination among state regulators.
- The IAIS adopted a guidance paper in 2008 on the role and responsibilities of a group-wide supervisor, with a further guidance paper on group-wide solvency assessment. The industry strongly supports these efforts: the CRO Forum believes that role of the IAIS should be strengthened by the introduction of binding rules – being standards or decisions – and that further regulatory convergence across borders should be encouraged.

Recent publications of the CRO Forum

Internal models benchmark study
30 January 2009

Addressing the pro-cyclical nature of Solvency II
25 November 2008

Public risk disclosure under Solvency II
17 November 2008

CRO Forum QIS4 Benchmark Study
31 October 2008

Liquidity Risk Management
29 October 2008

CRO Forum response to the financial crisis
23 October 2008

Market Value of Liabilities for Insurance Firms
28 July 2008

Response on EU harmonisations of reporting formats
1 July 2008

The CRO Forum is supported by a Secretariat that is run by:
KPMG Business Advisory Services
Burgemeester Rijnderslaan 20, 1185 MC Amstelveen or
PO Box 74500, 1070 DB Amsterdam
The Netherlands
Tel. +31 (0) 20 656 8283
Fax +31 (0) 20 656 8225
www.croforum.org