

FINMA Working Paper June/2010 – Abstract

# Assessing the potential for systemic risks in the insurance sector

## Considerations on insurance in Switzerland

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This is an abstract of the [FINMA Working Paper Juni/2010 “Systemische Risiken im Versicherungssektor?”](#). The English translation of the report follows and will be published on the FINMA website.

### 1 Aim of the report

The aim of this report is to develop an independent and differentiated view of systemic risks in the insurance sector, which can be brought into the on-going national and international debates, and to supplement the investigations conducted by the [“too big to fail” commission of experts](#) in Switzerland. The relevance of insurance to the real economy is a key driver behind this present study. Even if the insurance sector at large weathered the 2007/09 financial crisis rather well, with the notable exceptions of American International Group (AIG), the US monoline insurers, and financial conglomerates such as Fortis or Internationale Nederlanden Groep (ING), it is appropriate to review the soundness of the insurance supervisory regime to mitigate potential negative externalities originating from insurance operations.

### 2 Structure of the report

The report initially provides the backdrop against which the investigations are run. The criteria for systemic relevance of the Financial Stability Board (FSB), namely size, interconnectedness and (lack of) substitutability are then discussed from an insurance standpoint, bearing the insurance business model and insurance regulation and supervision in mind. The time criterion proposed by the International Association of Insurance Supervisors (IAIS) is accounted for since it is a key differentiating factor between the banking and insurance sectors. The specificities of the insurance business model and supervisory regime are expanded upon, emphasizing the major differences between both sectors. The discussion encompasses an overview of special supervisory measures, which the supervisory authority in Switzerland may adopt to protect policyholders.

The aforementioned factors combine to set the background for the discussion of seven qualitative scenarios investigating the impact of the failure of a key insurance function or institution on the financial sector and the real economy in terms of shortage of capacity or other spillover effects. The scenarios consider possible causes, impact, potential shortfalls of the supervisory regime, and mitigation measures regarding:

1. shortage of insurance capacity;
2. run on an insurance company;
3. contagion of a financial crisis to insurance investment activities;

in relation to capital markets activities:

4. default on credit default swap obligations;
5. default on leveraged investment activities;

and, in relation to the structure of corporations (groups and conglomerates alike):

6. default due to limited fungibility of capital and liquidity, and
7. non-insurance<sup>i</sup> activities.

The report proceeds to present the findings and proposes improvements to alleviate or possibly remedy the shortfalls of the supervisory regime identified in the various scenarios.

### 3 Findings

The existing supervisory regime supported by the traditional insurance business model proves to be fundamentally solid. No immediate systemic risks have been identified within insurance companies or legal entities regulated by the Swiss supervisory authority, and none of the institutions are considered too big to fail or too big to rescue for that matter. However, a number of shortcomings have been recognised in traditional insurance activities and non-insurance and capital markets activities:

- limited attention to liquidity;
- vulnerability of the reserving process;
- concentration risks in general and, in particular, with respect to reinsurance recoverables;
- regulation and supervision of non-insurance activities and capital markets activities, and
- regulation and supervision of corporations.

To conclude, rather than conducting a major overhaul, the existing supervisory regime should be enhanced to mitigate the identified shortcomings. Appropriate proposals are outlined in the full report.

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<sup>i</sup> According to Article 11 of the [Insurance Supervision Act \(ISA\)](#).