



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Études et Dossiers No. 344

The 24th PROGRES International Seminar

“Towards a Global Architecture for Insurance
Regulations and Supervision”

3-4 April 2008
Geneva, Switzerland

April 2008

Working Paper Series of
The Geneva Association

© Association Internationale pour l'Etude de l'Economie de l'Assurance


The Geneva Association Working Paper Series “Études et Dossiers” appear at irregular intervals about 10 - 12 times per year. Distribution is limited.

The “Études et Dossiers” are the working paper series of The Geneva Association. These documents present intermediary or final results of conference proceedings, special reports and research done by The Geneva Association. Where they contain work in progress or summaries of conference presentations, the material must not be cited without the express consent of the author in question.

Layout & Distribution: Valéria Kozakova

Current Considerations Concerning Reinsurance Mutual Recognition – Does it Affect Trade Issues?

Sebastian von Dahlen




Introduction

- **Typically** regulators want to ensure policyholder protection & financial stability
- **Reinsurance** works in an international environment but with national regulatory carve outs
- **However, is there potential overregulation?**
 - Intuitively: harm to worldwide market prosperity
 - Astonishingly: potential harm to national policyholders!
- **Solution:** IAIS work towards Mutual Recognition

4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

2



Outline of today's presentation

1. **Reinsurance: worldwide free market access?**
2. **Optimal level of reinsurance regulation?**
3. **Free trade and regulatory carve out**
4. **Collateral revisited – economic effects:**
 - On financial stability (relative clear result)
 - On national policyholder protection (mixed result)
5. **Conclusion**
 - International *and* national support to IAIS work on the mutual recognition of reinsurance supervision seems to be appropriate

4 April 2008 /
Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

3



Reinsurance ...

... **ideally worldwide free market access (I.)**


- **Business model of reinsurance**
 - Provides protection for major catastrophes
 - Requires spreading of risks (ideally global)




4 April 2008 /
Geneva

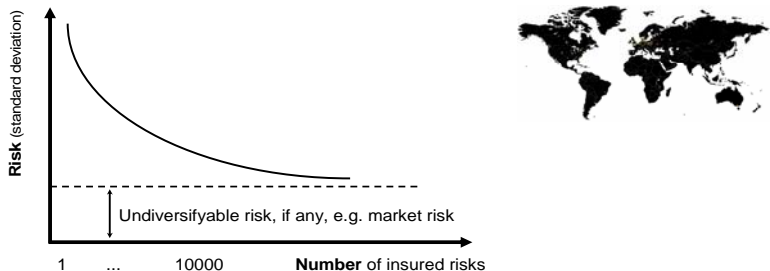
Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

4

 **Reinsurance ...**

... ideally worldwide free market access (II.)


- Economic foundation of reinsurance
 - Diversification, including geographical
 - Law of large numbers



4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

5

 **Reinsurance regulation: why and how?**


Ongoing considerations on optimal level


- Arguments in favour of regulation
 - Policyholder protection (question: reinsurance?)
 - Financial stability
- Towards most advantageous regulation
 - Regulatory level playing field (worldwide!)
 - Avoidance of inefficiencies (e.g. duplications)

4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

6

 Free trade and regulatory carve out (I.)



Traditional consideration: balance between:

- Additional **regulation** → increased security
- More **free-trade** → increased trade gains


• New argument today: balance regulation!


- Additional regulation → *increased* security
- Additional regulation → *decreased* security

4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

7

 Free trade and regulatory carve out (II.)



• Preliminary conclusions

- Diversification enhances global financial stability
- Revisited carve out → increased diversification?


• However, counterargument

- Global financial stability is only one aspect
- Regulatory focus: policyholders in jurisdiction!


4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

8



Observations on reinsurance regulation




- Our current knowledge
 - Financial stability: free market access (diverse!)
 - Policyholder protection: supports regulatory carve out
- Our empirical finding
 - Some request foreign reinsurers to post collateral
 - Justification: improve national situation (secure!)

4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

9



Collateral: national implications (I.)

Mixed result security: decrease or increase?

- Collateral: flawed security (*ceteris paribus* – “cp”)
 - Decrease of own risk assessment and ability
 - If all ask for collateral: less overall capacity
- Collateral: availability of protection impaired
 - Decreasing (re-)insurance protection (cp)
 - Increasing (re-)insurance prices (cp)

4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

10

Collateral: national implications (II.)

Decreased competitive position of cedants

- Economic explanation: if collateral required
 - Cedants face increased marginal costs for national insurance production
 - Cedants profit less from lower worldwide reinsurance prices
 - Most likely: impaired situation for national insurance policyholders


4 April 2008 / Geneva
Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen
11

The economic model

- **Collateral:** marginal cost insurance production increases *longer* according to "steep" line
- **No collateral:** marginal cost insurance production switches earlier to "flat" line

→ **Collateral could imply competitive disadvantage for insurers from country A**


4 April 2008 / Geneva
Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen
12



Conclusion

- Appropriate free market access for reinsurers could increase:
 - Overall financial stability
 - and*
 - National policyholder protection


- IAIS should work further towards the Mutual Recognition of Reinsurance Supervision



4 April 2008 /
Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

13

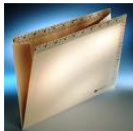


Outlook

IAIS on reinsurance mutual recognition

- October 2007: **Discussion Paper** on the Mutual Recognition of Reinsurance Supervision


- October 2008 (aim): **Guidance paper** on the Mutual Recognition of Reinsurance Supervision



4 April 2008 /
Geneva


Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

14

 Any questions?

Please consider also the IAIS website:

www.iaisweb.org



Also email at: sebastian.von-dahlen@bis.org

4 April 2008 / Geneva

Mutual Recognition of Reinsurance Supervision
24th Geneva Association PROGRES Seminar, Dr. Sebastian von Dahlen

15