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27. 04. 2010

International Association for the
Study of Insurance Economics

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**Geneva
Association
Information
Newsletter**

Geneva, April 2010

Financial Stability in Insurance – Letter to Finance Ministers and the G-20.

Geneva, 27 April 2010. The Geneva Association, the leading insurance ‘think tank’ has issued a letter to the Finance Ministers and Central Bank Governors of the G-20 following their meeting in Washington, D.C., taking into consideration also the current work on ‘financial stability contribution’ by the International Monetary Fund (IMF).

The letter states the views of 80 leading international insurance companies and is based on the extensive research work that The Geneva Association has carried out on financial stability issues in relation to insurance. It is signed by Dr Nikolaus von Bomhard, President of The Geneva Association and Chairman of the Board of Management of Munich Re Group, and Mr Patrick M. Liedtke, Secretary General and Managing Director of The Geneva Association.

The text of the letter is as follows:

G20 Letter

To the Finance Ministers and Central Bank Governors of the G-20

The financial stability tax proposal of the International Monetary Fund (IMF) fails to adequately address the distinct nature of the insurance industry and its stabilising role in the economy. The application of such a proposal even seems contradictory, given that the insurance industry did not cause the crisis in the first place and was instead a victim of the consequences, through asset devaluation, recessionary development of the economy and a very low interest environment.

The IMF’s interim proposals to levy a financial stability tax on all financial institutions does not sufficiently take into account the important fact that the business model of insurers differs significantly from that of banks. In exchange for the payment of a premium, insurers commit to financially compensate the customer for losses suffered on the occurrence of an insured event set out in a contract. The insurer must use the premiums to invest in assets that match the expected amount of compensation payable under protection provided and the duration of the risks covered. Consequently insurers have relatively stable asset portfolios – which explains the limited impact or need for government support for the overwhelming majority of insurers during the financial crisis. Conversely, banks are subject to short term liquid deposit demands and have credit

risks related to lending activities and liquidity risks due to the mismatch arising from borrowing short and lending long.

In our analysis of the relationship between systemic risk and insurance (*Systemic Risk in Insurance – an analysis of insurance and financial stability*, March 2010), our research shows that core insurance activities do not create systemic risks. It also identified a very limited number of activities that could give rise to systemic risks. But these activities are not core to insurance, are incidental and present a risk only if conducted on a massive scale, as in the case of AIG Holding Co., without due risk management or effective supervisory oversight. Aside from a small number of well publicised examples, the insurance industry weathered the financial storm in relatively good health. Pensions were paid, policies were underwritten and honoured and customers were able to take personal and entrepreneurial risks.

It is important that the initiatives in response to the crisis address the activities (not the companies as such) that could pose a risk to the system by encouraging more transparency as well as better governance and risk management. Our report identifies measures to address the non-core insurance activities that can in theory cause systemic risks within the existing and proposed supervisory framework. Our proposals avoid the need for additional costs being placed on customers, a reduction in the capacity for protection and a distraction of supervisory focus that could occur with the inappropriate and arbitrary application of proposals such as that proposed by the IMF.

At this time of crucial economic decisions, what is needed is proportionate and appropriate solutions that strengthen the financial system and enable governments to address the challenges of the future. It is important that the different roles and risks faced by financial institutions in the system are clearly identified and addressed in a focused way accordingly. This needs to be recognised in the discussions on any potential solution proposed to protect the system.

The Geneva Association's research and the Systemic Risk Report are contributions by the industry to strongly promote an active and constructive dialogue between governments, regulators, supervisors and the insurance industry in addressing the challenges created by the financial crisis. We hope that the solutions implemented by governments and regulators to repair the damage caused by the recent crisis are fully considered and target the specific shortcomings identified.

Should you wish to discuss the contents of this letter or our systemic risk report in more depth, The Geneva Association would be delighted to engage further in this matter.

Yours faithfully,

Dr Nikolaus von Bomhard
President of The Geneva Association
Chairman of the Board of Management, Munich Re Group

Patrick M. Liedtke
Secretary General and Managing Director
The Geneva Association

For further information, please contact:

Anthony Kennaway
Head of Communications, The Geneva Association
Tel. +41 22 707 66 06
anthony_kennaway@genevaassociation.org

The Geneva Association

The Geneva Association is the leading international insurance “think tank” for strategically important insurance and risk management issues.

The Geneva Association identifies fundamental trends and strategic issues where insurance plays a substantial role or which influence the insurance sector. Through the development of research programmes, regular publications and the organisation of international meetings, The Geneva Association serves as a catalyst for progress in the understanding of risk and insurance matters and acts as an information creator and disseminator. It is the leading voice of the largest insurance groups worldwide in the dialogue with international institutions. In parallel, it advances—in economic and cultural terms—the development and application of risk management and the understanding of uncertainty in the modern economy.

The Geneva Association membership comprises a statutory maximum of 80 Chief Executive Officers (CEOs) from the world’s top (re)insurance companies. It organises international expert networks and manages discussion platforms for senior insurance executives and specialists as well as policy-makers, regulators and multilateral organisations. The Geneva Association’s annual General Assembly is the most prestigious gathering of leading insurance CEOs worldwide.

Established in 1973, The Geneva Association, officially the “International Association for the Study of Insurance Economics”, is based in Geneva, Switzerland and is a non-profit organisation funded by its members.

For more information please visit www.genevaassociation.org.