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Press Release: Financial Crisis strongly reinforces the case for Solvency II. EU should not water down the Solvency II directive or postpone the legislative process

New CRO Forum publication comments on the consequences of the financial crisis for Enterprise Risk Management and regulation in the insurance industry

The CRO Forum responds to the recent developments in the financial markets, stating that the credit crisis has raised serious questions about the effectiveness and efficiency of risk management within the financial services industry. This publication, written from an insurance industry perspective, focuses on the implications of the crisis for Enterprise Risk Management (ERM) and regulation in the insurance industry, in particular for Solvency II.

The insurance industry is not immune to the effects of the current crisis. Insurance companies have significant asset bases that are affected by the currently depressed market values of assets. However, the CRO Forum believes that this crisis, which is characterized by a collapse of credit markets and the subsequent drying up of liquidity, naturally affects the insurance industry to a lesser extent. Insurers are primarily funded by policyholders, which is a more resilient source of funding.

The CRO Forum believes that the crisis reinforces the case for Solvency II, in particular its principle based, economic and risk-sensitive approach. The group supervision and the group support regime, two core elements of the Solvency II framework, will foster cooperation between national regulators, which is essential for the stability of the insurance industry.

“Solvency II is the right response to the challenges of a crisis like this. In many respects, Solvency II is a reflection of the advances that the insurance industry made in terms of ERM in the aftermath of the 2000/2003 crisis created by the burst of the dot-com bubble. These efforts have clearly helped the European insurance industry to navigate through this crisis”, says Jo Oechslin, Munich Re Chief Risk Officer and Chairman of the CRO Forum.

Insurance regulation should address the issue of pro-cyclicality, according to the CRO Forum. In particular, forced sales of assets in market downturns should be discouraged. A decrease in available capital as a result of distressed market prices of assets should not require immediate regulatory intervention. The CRO Forum strongly believes that this should be dealt with in Pillar 2 of the Solvency II framework as part of the regulators' ladder of intervention, rather than reflected in the capital requirements.

"EU legislators should not water down the Solvency II directive or postpone the legislative process. This would be like terminating a marathon at the 40 kilometer mark", adds Oechslin.

In this publication, The CRO Forum states its belief that although risk models are indispensable for managing the business, results from these models must be complemented with effective internal controls - and common sense.

The CRO Forum also gives its view on the market-consistent valuation principles building the foundation both of Solvency II and of its members' risk models. It argues that insurance liabilities as a whole are usually not traded in liquid financial markets, but are instead often fulfilled over a contract's lifetime. Market-consistent valuation therefore means that components of the insurance liabilities that can be replicated in liquid financial markets should be valued at market value, and the components that cannot should be marked to model. This requires the approach to be dynamic, since the liquidity of markets can change over time.

Given the huge market value losses within certain financial institutions, the CRO Forum expects to see management and regulators seeking to further strengthen ERM functions, resulting in growing powers and responsibilities for CROs and their teams.

<http://www.croforum.org/publications.ecp>

The Chief Risk Officer Forum ('CRO Forum') is comprised of the Chief Risk Officers of the major European insurance and reinsurance companies. It was formed in 2004 to work on key relevant risk issues for advanced practitioners.

The CRO Forum is a professional risk management group focused on developing and promoting industry best practices in risk management. It intends to present large company views, with three core aims:

- Alignment of regulatory requirements with sophisticated / best practice risk management
- Acknowledgement of group synergies, especially diversification benefits
- Simplification of regulatory interaction

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Note for editorial departments

In case of enquiries, please contact:

Klaus Schmidtke

Tel.: +49 (0)89 38 91-88 05