Financial convergence and supervision

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Overview

• Insurance market trends
• Systemic concerns?
• Optimal structure of supervision
Market trends

- Product structure:
  - More composite products
  - Shifting of investment risk to consumer
  - Many traditional ‘pure‘ insurance products remain
  - Pension provision: several options
Market trends

• Supplier structure
  – Divergent strategic options
  – Presently ongoing consolidation, cross sector, cross border
  – Still many ‘pure’ stand alone insurers
  – Pension provision: several options
Market trends

• Distribution structure
  – Intermediaries (‘independent’) still dominant
  – Tied agents
  – Direct writing
  – Internet: still limited but increasing
Market trends

• Consumer and political expectations:
  – More aware consumers
  – Better ex ante product information
  – More ongoing information
  – Share of the positive investment returns
  – No failures accepted
Market trends

- A continuing important role for insurance
- Traditional banking (transformation function) under more threat?
Systemic concerns?

• Increasing interest by:
  – IMF, FSF etc.
  – Central banks
  – Banking supervisors

• Financial Sector Assessment Programs
Systemic concerns?

- Limited relevance for the primary insurance sector
  - Liabilities:
    - No ‘run on the bank’
    - Very limited intra-group guarantees
  - Assets:
    - Very liquid exchange traded assets
    - Government bonds, large cap equities
    - Very little direct claims on other insurers or on banks
Systemic concerns?

- Some relevance for the reinsurance sector
  - Liquidity risk
  - Retrocession (less than previously)
Systemic concerns?

- Within financial conglomerates
  - In the European Union also of limited relevance:
    - For insurers: assets covering the technical provisions must be unencumbered
    - Intra-group transactions and positions are supervised
    - Post BCCI Directive: transparency
    - Draft Financial Conglomerates Directive
    - In NL: group wide supplementary supervision, including solvency assessment
Optimal structure of supervision

• Historically, in the insurance sector:
  – The insurance entity is holder of liabilities and assets vis-a-vis the policyholders
  – Solo supervision of the insurance company
  – Solo-plus
  – Financial solidity
  – Specialised supervision
Optimal structure of supervision

- Current arrangements in the Netherlands:
  - Pension & Insurance Supervisory Authority
    - Pension funds
    - Insurance companies
  - De Nederlandsche Bank, i.a.
    - Credit institutions
    - Collective investment funds
    - Central bank
  - Securities Supervisory Authority
    - Securities firms
    - Stock exchange
Optimal structure of supervision

• Current arrangements in the Netherlands:
  – Various bilateral Protocols (since 1990)
  – Co-operation is increasing
• International co-operation agreements:
  – Mainly EU wide
  – Also on individual groups (Fortis)
Optimal structure of supervision

• Increasing question marks:
  – Increasing convergence
  – Dual purposes of supervision
    • Financial solidity
    • Consumer information
  – International changes in legislation
    • US (Gramm-Leach-Bliley Act)
    • EU Conglomerates
  – International changes in structure
    • EU (UK, Germany towards integrated supervision)
    • US (FHC, role FED)
Optimal structure of supervision

• Complications:
  – For insurance ‘bottom up’ solo plus is preferable
  – For banking ‘top down’ consolidated is preferable
  – Role of cross-border competences (very relevant in the EU)
  – Dual supervisory aims are sometimes mutually reinforcing, sometimes potentially conflicting

• Studies (OECD, IMF, G10) indicate that no single supervisory structure is optimal for all jurisdictions at all times

• Priorities will partly be incident driven
Optimal structure of supervision

- Renewed discussion in the Netherlands
- Proposals by the Ministry of Finance:
  - Separation between prudential and market conduct supervision
  - Closer co-operation between the two prudential supervisors (Pension & Insurance Supervisory Authority and the Nederlandsche Bank)
  - No separation between banking supervision and the central bank functions
Optimal structure of supervision

• View of the Pension & Insurance Supervisory Authority:
  – Proposals reflect:
    • Widely felt need for closer co-operation on prudential aspects
    • Understandable political priority for consumer information and protection
  – However:
    • Deviate from other choices in the EU
    • Introduce more than one supervisor for each financial firm
    • Reflect the current situation at the larger players, but not that at the many smaller insurance companies
    • Thus implicitly reflect a market view by Ministry of Finance
Optimal structure of supervision

- No such thing as specialised versus integrated supervision
- Market structure and consumer expectations dominate the optimal balance
- Keep ‘checks and balances’ in the overall infrastructure