Testimonies

THE ROLE OF INSURANCE COMPANIES MUST BE INCREASED

Is it necessary to increase the duration of insurance liabilities, and if yes how?

Allianz and AXA

The whole French Insurance market welcomes the recent creation of the EuroCroissance contracts. This regulatory change, like the previous regulations on PERP and PERE a few years ago, is contributing positively to the increased ability of insurers to support long term corporates funding, and therefore to play their natural role of long term financing of the economy.
This evolution is going into the right direction but, as in the other European countries, there is a need to go further and to develop the appetence of French citizens for long term investment solutions and especially complementary retirement products. The main long term resource is the complementary and supplementary retirement, and we think that the development of the French market of occupational and personal retirement savings should be a top priority. The building up of individuals and corporates of retirement provisions on top of those provided by the state repartition systems will allow insurers to invest more in the long term, and will simultaneously represent an adequate answer to the ageing of the population and the difficult situation of public finances. Retirement savings are an inescapable way to guarantee acceptable/ adequate revenues to the retirees and to ensure sustainable pensions schemes in the long run. The consequence of the increase in the share of retirement provisions in the insurers' liabilities will actually be an increase in their duration.

In favour of a European regulation more oriented towards the long term?

Allianz

Solvency 2 and the IFRS accounting standards are relying mainly on the notion of economic balance sheet and air value, which makes sense, but there is an amalgam between fair value and market value. But the market can evolve in very erratic times when the market prices do not reflect any more the true "economic" value of the assets and liabilities. The market value reference introduces a very high volatility, especially for own funds and long term assets. These long term assets will be the first sold in situations of crisis, reinforcing the procyclical nature of the financial system. As a result there is a double penalty for long term investments, as they will at the same time reduce the available own funds and increase the capital requirements during stress periods. Some efforts have been been made with the long term guarantee assessment, but we need to go further. We support the possibility to derogate to the market value when it diverges too much away from the economic value, and to calibrate the Solvency 2 shocks on a longer term horizon. A specific treatment for long term investments would allow to increase their use in the portfolios.

AXA

The ongoing development of international accounting standards (IFRS) and the reform of the prudential supervision of insurance companies (Solvency 2) generalise the Mark to Market Valuation (MtoM) of the balance sheets of insurance companies. Insurers, for the sake of compromise, have accepted these regulatory changes. However, they must be compatible with their business model.
For this purpose, adjustments must be made in order to mitigate the generation of excessive volatility in the income statement and available own funds to cover the solvency margin. These standards must also take into account the long-term vision of insurers and the specificities of their assets backing liabilities. Insurers asked the IASB, the organization which has been delegated the initiative in drafting accounting standards, to review their recent draft stan-

dard on insurers' liabilities (IFRS 4). The standard, if adopted as it stands, would create excessive volatility in the income statements of insurers because they would not properly reflect the necessary asset liability matching. This is why European insurers, concerned about maintaining consistency between the valuation of assets and liabilities, recommend to the European Commission not to endorse the standard on financial assets (IFRS 9) as long as the standard on insurance liabilities has not been fundamentally reviewed. Besides, the European insurance industry unanimously requested that the Solvency II implementing measures ("delegated acts") proposed by the Commission send a clear and strong message in favour of long-term investment. Infrastructure, SME financing and the use of securitisation should be encouraged; to do so, the Commission may rely confidently on the experience of insurers, historical data, to retain adequate calibration and avoid the excessive calibration currently proposed. This would allow insurers to fully contribute to the recovery of the European economy."

What respective roles for banks and insurers on the financial markets?

Allianz

The role of banks and insurers in the financing of the economy cannot be exactly the same. The proximity with the corporates and their treasury is the core nature of the banking sector. However the financial intermediation is also performed by insurers, and the fact of lending money is equivalent to investing. The banking monopoly should not persist in its current form for corporate lending as it already disappeared through the role of the financial markets. A more liberal regulation on corporate lending would definitely make sense, to allow the insurers to finance the corporates without constraints. The time spend on credit analysis could be reduced if the terms of the loans/bonds would be more normalized, and also by the development of analysis aggregators, that could be the banks themselves, the asset management companies or the rating agencies. The public authorities should accompany this evolution by favouring the introduction of issuance norms, and also by collecting databases on issuers financials. The creation of quality labels, or even the credit enhancement of some securitizations, would also enable a much quicker development of banking disintermediation.

AXA

Improving the intermediation of private savings towards long-term financing of the economy makes necessary an increased cooperation between banks and insurance companies which considers their respective economic models. Banks, thanks to their daily knowledge of company accounts, have a fundamental role on the retail market of small enterprises short term and working capital funding needs. They can make easier insurance investments in SMEs by homogenising and securitising individual loans. It will provide for the use of insurance statistical risk underwriting tools. On this last point, banks and insurers must work together to promote quality securitization and avoid the abuses seen before the 2007-2008 crisis.

For their part, institutional investors, due to the duration and illiquidity of their liabilities are able to provide the market with stable long-term financing. The supply of bank funding is cyclical by nature conversely to the permanence of institutional investors offer. Even in times of crisis, underwriting activity generates premiums, and stable investment flows from insurers. The alternative supply of insurance funds is thus particularly suitable for the long-term projects of companies. As well infrastructure projects with slow development require more permanence and stability.

Interview realised by
Jean-Robert Léonhard
Senior advisor, Confrontations Europe

1) www.confrontations.org