Thank you!

You’ve just accessed a PDF on Fast Fast Forward, XL Group’s online platform for sharing news, commentary, and ideas about business challenges. Here, we share thoughts about persistent risks and emerging ones; new ideas; innovations; and risk management strategies that help keep businesses moving forward. We’re a (re)insurer and risk is our business.

We invite you to explore more:  
xlgroup.com/FastFastForward

Enjoy!
There has never been a greater regulatory focus than now on ensuring financial institutions have sufficient capital to cope with extreme events, liabilities and financial stresses. Extreme, but not unforeseen, which is why, after a mere 17 banking crises around the globe in the last 40 years, the regulators have turned full square to the banks and the executives who run them seeking assurances about the solvency and efficacy of those institutions.

However, it’s not just the banks who are the target of new regulations requiring the setting aside of capital; other financial institutions are being required to follow a similar path. For instance, the insurance industry is moving slowly towards Solvency II or equivalent, borrowing much from banking’s Basel themes, while the fund management industry around the globe is facing fresh regulatory and capital requirements too.

This reaction, perhaps, is not unreasonable bearing in mind the mess caused by the last global financial crisis, the public’s general distrust of financial institutions, fuelled enthusiastically by the media and politicians alike, and the multitude of ethical and consumer protection issues that have arisen subsequently out of the conduct of the banks both before and during the crisis.

Allegations of product mis-selling against financial institutions have become commonplace, but we have seen it on a different scale in the last few years; add in the scandals surrounding allegations of manipulation of benchmarks and interest rates, the alleged facilitation of money laundering and sanctions-barred transactions, and so forth, and it is not hard to see why the regulators are stepping in. Their impact will be felt as they are freshly empowered by politicians, to impose stricter controls, through increased regulation, scrutiny and fines.

The problem for the financial institutions is that, by being required to hold additional capital on their balance sheets, there is very little they can do with that capital. That of course is the point: certain amounts of capital are meant to remain relatively risk free in order to meet those rainy-day events. However, there is already precedent under the Basel rules to recognise that insurance may be utilised as a partial mitigant for that capital, thereby freeing up the financial institution to utilise the capital more effectively, with the hope of generating better investment returns for their shareholders.

The insurance industry has been slow to respond to this development. The traditional silo-led approach has been to drive the requirement of the financial institution customers into existing products. So, big solutions for big clients with big capital transfer requirements have been the (largely unsuccessful) focus without stopping for thought about what really creates value. Value not just for and within financial institutions, but also solutions that are sufficiently robust so that the regulators can consider them as fully part of the various risk mitigants available and appropriate for an organisation attempting to manage their risks in a prudent manner.

The challenge is that the insurance industry needs to develop innovative risk transfer solutions which enable this capital to be released. We have set up a new operational risks team based in London with a worldwide brief to develop and provide insurance products. Angelos Deftereos joins from Morgan Stanley Wealth Management, where he was responsible for the implementation of the operational risk programme.

With the establishment of this team, we will be working with organisations across the financial institutions sector to develop solutions that enable our clients to utilise insurance alongside their capital requirements, thus remaining relevant to organisations’ risk assessment and mitigation strategies in an increasingly complex and regulated environment.

Gerard Bloom, chief underwriting officer, financial institutions, International Professional, XL Group

Time to step up

Time for the insurance market to step up to the capital challenges faced by financial institutions