“The role of insurance in the recent financial crisis”

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Abstract

The current financial crisis was primarily a banking crisis and the solvency of the insurance sector as a whole was not threatened. Nonetheless, while insurance companies as a group may have cushioned rather than amplified the downward pressures during the financial crisis, some clearly have added to downward pressures. Financial instruments such as credit default swaps that were at the core of difficulties served an insurance function and, thus, it is not so surprising that some institutions from that sector have been affected by the crisis on one or the other side of their balance sheets. As a result of recent experiences, however, insurance companies may adopt a sharper focus on their traditional business activities, going forward.

Keywords: financial crisis, role of insurance function and companies, financial groups and "ungrouping".

Introduction

What has been the role of insurance in the recent financial crisis? Different answers exist regarding that question, reflecting among other things differences in the interpretation given to some financial contracts that were at the heart of the recent financial crisis. One view, which is shared among at least several insurance industry representatives, is illustrated by the following statement:

"There are no indications whatsoever that insurers have contributed to the systemic issues that many banks are facing today. Insurers have not originated and repackaged subprime mortgages. They did not act as major investors in mortgage-based financial instruments. To the contrary, the insurance industry displayed resilience in the face of adverse market conditions and was in a position to absorb market volatility as an institutional investor with a long-term perspective. In this sense, the insurance sector acted as a stabilizing factor at a time of considerable stress in the global financial system"[1].

Perhaps at the other end of the spectrum of views is that expressed by the Chief Executive of the US-based insurance company Allstate, as quoted with the following argumentation:

"It was, after all, an insurance product that contributed to the risk that almost brought down the global economy. It should be no surprise that a big insurer like AIG would be a major issuer of credit default swap. What is surprising is the claim that insurance did not contribute to the recent market failures, and therefore, insurers don't need to consider how to prevent them from happening again"[2].

The present paper argues that these two views can be reconciled, at least to some extent, by acknowledging the differences in the interpretation of credit default swaps (CDS). These instruments have been part of the causes for, and factors amplifying the extent of, this crisis. At least some types of CDS are similar to insurance contracts and, thus, an *insurance function* has been very much involved in this financial crisis. That being said, this interpretation may or may not have implications for the role of insurance in an *institutional sense*, that is for the role of insurance companies in this crisis. Insurance companies, however, are now providing a growing range of financial services and, as traditional boundaries between banking, insurance and other types of financial service providers have become increasingly blurred, reflecting convergence in some of the products offered and the provision of different financial services in complex financial groups, it is not so surprising that some insurance companies have been very much involved in this crisis. In some of these entities, vulnerabilities exposed by the crisis reflected the provision of insurance against credit risk through the writing of CDS.

1. An insurance-like product at the core of the risk transfers preceding the crisis

While the discussion about the causal factors for the crisis is ongoing, there is broad agreement that a number of different factors have been at play, not

The author is Principal Economist in the Financial Affairs Division of the Directorate for Financial and Enterprise Affairs of the Organisation for Economic Cooperation and Development. The present article draws in some parts on an article prepared by the author for and presented at the meeting of the OECD's Insurance and Private Pensions Committee in July 2009 and subsequently released in October 2009 in the OECD's Financial Market Trends (Schich, 2009a), but it goes beyond that article, however. The opinions expressed and arguments employed here do not necessarily reflect the official views of the OECD or of the governments of its member countries. The author is grateful for comments from Stephen Lumpkin, Thomas Russell and an anonymous referee.

[1] See "The Credit Crisis and the Insurance Industry: 10 Frequently Asked Questions" (The Geneva Association, Etudes et Dossiers No. 351), response to question 1: "Have insurers contributed to the subprime and subsequent financial crisis? A more recent assessment by the CEA is as follows: "The specific characteristics of the insurance business model and the management of assets and liabilities by insurers have protected the insurance industry from the worst impacts of the financial turmoil. This model is entirely different from banking and, with very few exceptions, has shown resilience to the continuing shocks to the financial system." (CEA Letter to Rt. Hon. Gordon Brown MP ahead of G-20 Summit Meeting in London).

[2] The New York Times, "Regulate Me, Please", 16 April 2009.

just a single one. Having said that, most commentators agree that the fundamental change in the bank business model that occurred during the last decade or two is *one* of the significant causal factors: banks, rather than holding loans until maturity on their own balance sheets, instead focused on originating and distributing risks such as credit risks. Such a change in business model was accompanied by the spreading of innovative financial instruments.

There has been a long-standing debate on the advantages and disadvantages of this new business model. The general view was that it permitted a wider spread of risk, away from bank balance sheets and towards portfolios of other entities, perhaps better able, but more likely just more willing, to bear the additional risk. This view needs to be reassessed, however, given the experience during the recent financial crisis (Acharya et al., 2010). In fact, it has been argued that starting in the late 1990s banks stopped taking their assets off their own balance sheets, bundling these assets up into securitized bonds, and selling them on to other investors. Instead, they increasingly engaged in forms of securitization whereby they kept the assets on their balance sheets, but sold off synthetic collateralized debt obligations (CDOs). This practice was reflected in continued substantial growth of banks' balance sheets. With hindsight it is clear that not as much credit risk has actually been transferred than had been expected by many observers and the banks themselves. It is also clear that too much additional risk has been created in that process, with indebtedness rising significantly in many sectors of the economy, including, in particular, in household sectors to levels that proved to be unsustainable.

What is sometimes overlooked in this context is that the capacity of banks to change their business models as described depended on the availability of credit risk transfer instruments and on other investors willing to add them to their portfolios. In this context, some insurance companies, as large investors in international financial markets, have added credit risk to their portfolios, like many other investors, while other insurance companies have provided enhancements that made these instruments more attractive for many investors.

Another aspect that is often overlooked is that the massive transfer of credit risk involving entities from various financial sectors has at the core relied on an insurance-like financial instrument: credit default swaps (Figure 1). A credit default swap (CDS) is a contract under which the protection seller agrees to make a payment to the protection buyer in the event that the referenced entity, typically a company issuing a bond, experiences one of several so-called "credit events", which are bankruptcy, reorganization, or default. The protection seller receives a fee in exchange for this promise. Originally, CDS were used in the context of bond issues, essentially transferring part or all of the risk of the owner of the bond to the seller of credit protection. Literally, the protection buyer "swaps" the risk of default with the protection seller and, in the event of any number of the various credit events actually occurring, the owner of the bond suffers the associated loss on that position, while the swap contract provides full or partial recovery of that loss.

This type of transaction may be referred to as a covered credit default swap, to the extent that the buyer of credit protection through a CDS also owns a bond issued by the reference entity. It helps the owner of the bond to manage the risk associated with the bond investment. It is similar in this respect to a standard insurance contract.

But CDS transactions are not necessarily linked to specific bond positions on the part of the protection buyer. Actually, CDS can be sold or bought between counterparties independently of any specific bond or other asset positions on the part of either of the parties involved, and indeed, this aspect explains a large part of the rapid growth of the CDS market since its inception.

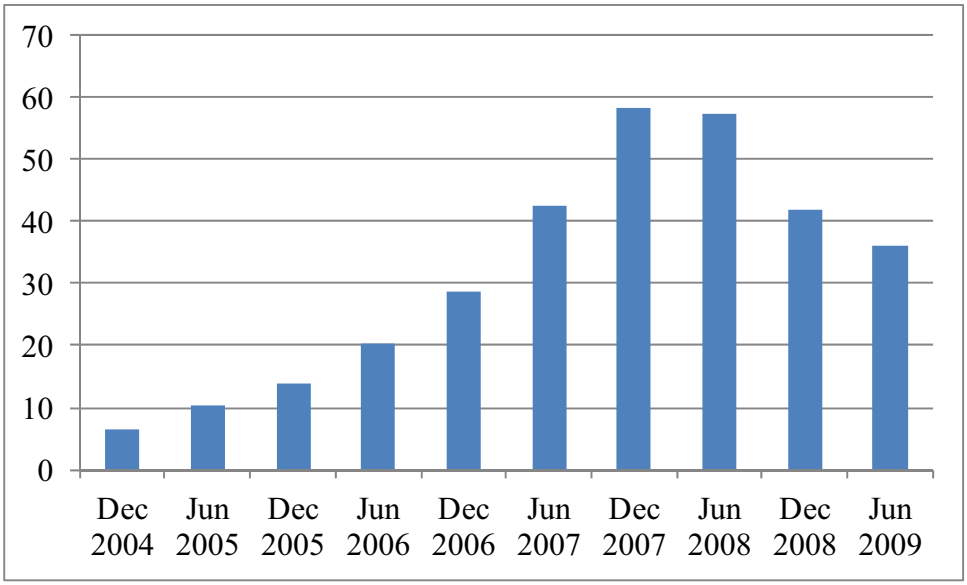
In this context, the New York State Insurance Department, in May 2008, began using the term "naked CDS" to describe swaps in which the protection buyer does not own the particular reference obligation. The motivation behind the use of the term "naked" as opposed to "covered" appears to have been an attempt to distinguish contracts depending on the motivation for writing them, that is in terms of the mix of either insurance versus speculation motives[1]. Clearly, in practice, distilling the motivations of partners to financial transactions is notoriously difficult. On September 22, 2008, the New York State Insurance Department announced that it planned to begin in 2009 regulating (covered) credit default swaps as a type of insurance contract[2]. In the meantime, the issue of regulation of CDS more

[1] In a way, one might argue that "naked" swaps are not "swaps" properly speaking, as there is no transfer or swap or risks, but instead risk is created by that transaction. See, for example, "Supervisory Lessons From the Current Financial Crisis: Initial Observations From the United States", The Geneva Association PROGRES Report No. 48, December 2008.

[2] See New York State Insurance Department Circular Letter No. 19, dated September 22, 2008.

generally has been intensively discussed in various international forums and the proposals currently under discussion include establishing an exchange, a central counterparty and a clearing house for CDS.

Whatever the specific outcome of these discussions, the main point that is relevant for the issue under consideration in the present paper is that CDS, at least some types of CDS, are similar to insurance contracts. Thus, it would seem that, the *insurance function* has been involved in the run-up to and evolution of this financial crisis, at least on a conceptual level (although, it needs to be acknowledged, this argument is not specific to this crisis; it applies to any financial crisis involving the materialization of credit risk). In any case, these considerations regarding the insurance function broadly defined may or may not have implications for the role of insurance in an *institutional* sense, that is, for the question of the role of *insurance companies per se* in the current crisis. More often than not insurance companies are effectively prohibited from writing credit default protection through CDS. But, as discussed in the next section, there have been some notable exceptions.



Source: BIS, Semiannual OTC derivatives statistics at end-June 2009, September 2009.

Fig. 1. Growth of activity in credit default swaps (notional amounts outstanding in USD trillion)

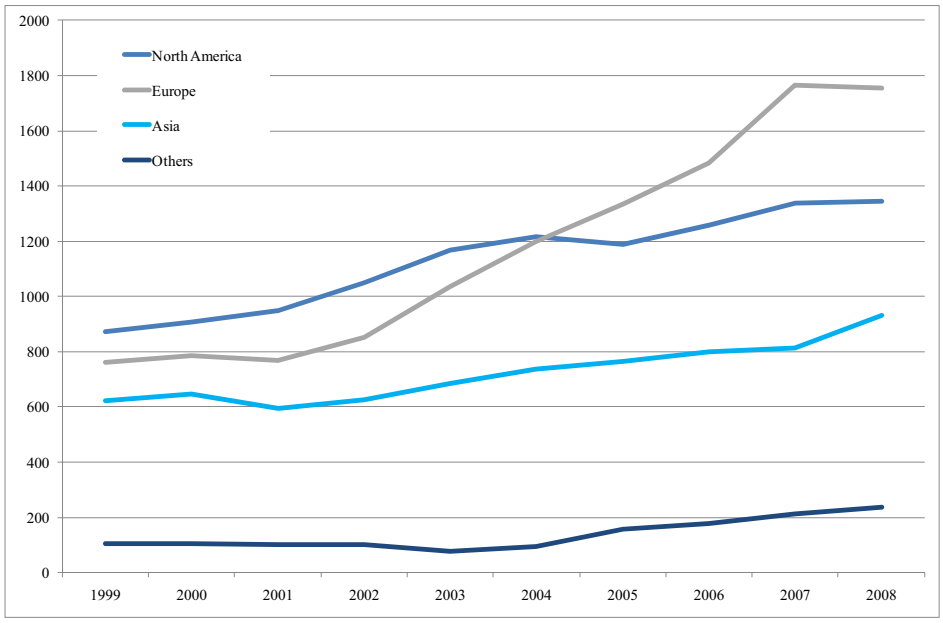
2. Developments in insurance sectors

Insurance sectors have been a stabilizing factor on aggregate...

The conceptual considerations developed in the previous section notwithstanding, exposure of most insurance companies to the financial crisis has been primarily through their investment portfolios. Insurance and reinsurance companies are major investors in capital markets. They tend to have widely diversified portfolios and to focus on high-quality investments. Thus, they were relatively well protected initially during the period of financial turbulence, when asset value declines were concentrated in lower-quality and higher-risk assets. These companies became increasingly more affected, however, as the turbulence developed into a full-grown crisis in which even high-grade securities were significantly affected. Conversely, as the crisis has abated the subsequent price gains in several markets have provided these investors with relief in this respect.

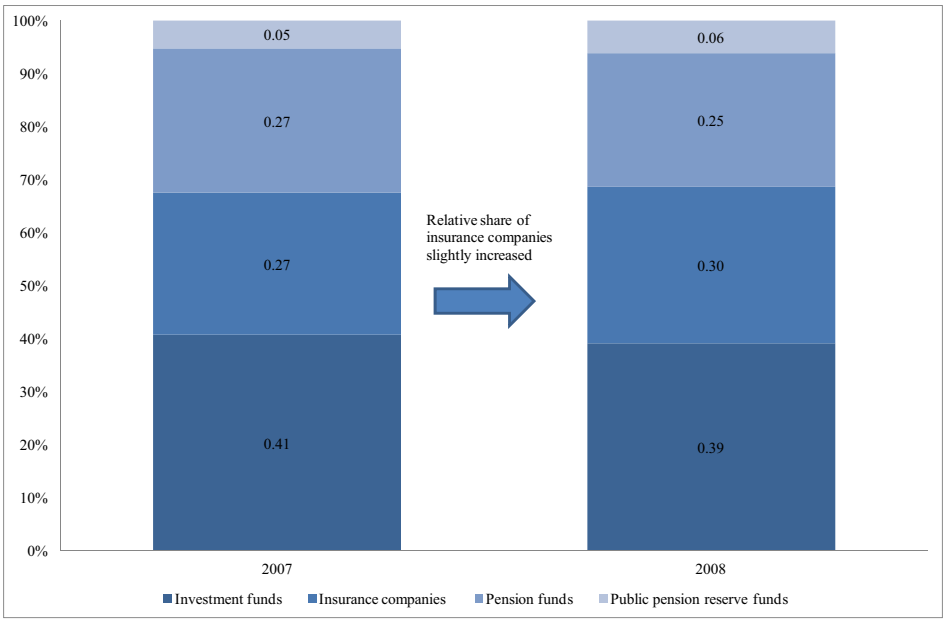
The fundamental nature of the insurance sector is to act as a shock absorber to the real economy. The claims paid by an insurance company reflect a compensation received by the insurance policyholder, which should mitigate the consequences of its financial or other type of misfortune. Thus, by providing protection against a variety of hazards, the insurance sector allows households and corporates to engage in activities that they otherwise would not have engaged in for fear of the consequences of loss. As a result, the availability of insurance encourages productive investment and innovation, and thus, supports real activity growth. This growth, in turn, should be beneficial for the growth of financial markets. By contrast, the absence of that type of protection could create severe problems for the economy, thus creating negative repercussions for the development of financial markets. Thus, to the extent that insurance sectors continue to provide fundamental insurance services during a financial crisis, they exert a stabilizing influence on both real activity and financial market growth.

During the recent financial crisis, most insurance companies have indeed continued to provide such protection. Premium incomes have continued to increase until 2007, especially in life insurance business, although the situation has been less favorable during 2008, except for Asia (Figure 2). Actually, according to some estimates, global insurance premium income may have fallen (in real terms) for the first time since 1980. To the extent that insurance companies realize net profits from their insurance business activities, they could reinvest the proceeds profits in financial markets, which would tend to support prices. Indeed, such a stabilizing mechanism has operated during the recent financial crisis. Insurance companies, on aggregate, have continued to be one of the largest investors worldwide just after investment funds, with the relative share of assets under management within selected major investors even slightly increasing (Figure 3).



Source: International Financial Services London, Insurance 2009, December 14, 2009.

Fig. 2. Global insurance premium volume by region (in USD billion)



Notes: Estimates of relative shares using data for those OECD countries for which similar data are available for both years. The total assets of the selected financial sectors shown above are estimated to have declined from about USD 55 at end-2007 to 48 trillion at end-2008.
Source: Authors' estimates based on data for pension and public pension fund reserve data from the OECD Global Pension Statistics and for insurance companies and investment funds from the OECD Institutional Investors database.

Fig. 3. Relative shares in total assets under management of selected financial sectors, in USD billion

Insurance companies, especially life insurance companies, are financial institutions with longer-term liabilities than commercial and investment banks and thus, they have the capacity to adopt investment strategies with longer-term horizons (Geneva Association, 2010a). To the extent that they adopt such strategies and do not sell into falling markets when many other types of investors do, they are a stabilizing element of the financial system. Most parts of the insurance industry appear to have acted as a stabilizing element in this sense during the current crisis (Geneva Association, 2010b)[1].

...unlike those insurance companies that had provided credit protection through CDS

While the insurance sector as a whole has been a stabilizing factor, a number of concentrated exposures to liquidity, credit or market risks have been revealed, however, in specific segments on either side of insurance companies' balance sheets. These companies include mortgage insurers, life insurance companies, financial guarantee insurance companies and at least one large insurance dominated financial group. These exposures led to an amplification of downward pressures. In this regard, perhaps the most egregious example is afforded by financial guarantee insurance companies and the financial product unit of a large and complex insurance-dominated financial conglomerate, who had sold credit protection via credit default swap.

Financial guarantee insurance companies have been under market pricing and rating pressures, as losses and write-offs mounted on mortgage-related structured securities for which they had provided credit enhancements, especially when such protection was in the form of financial derivatives sold. Losses on these instruments, unlike on traditional insurance contracts, showed up rapidly in the profit and loss accounts of these entities.

The large financial guarantors have now lost their triple-A rating status. This observation is remarkable, as the high rating was the core of their business model: essentially, their (traditional) business consisted of renting out their high rating to lower-rated debt issuers, guaranteeing the servicing of interest and principal payments on the debt issues of the latter as these payments become due[2].

Financial guarantee insurance companies have thin capital layers and tend generally to be highly leveraged institutions. As a consequence, to the extent that they are forced to deleverage during times of stressed market liquidity, they tend to add to dislocations in credit markets and exacerbate systemic risks. As the ratings of these companies were lowered, their equity prices fell and premiums for insurance against credit default by these entities rose. And the difficulties experienced by these companies fed back in to the value of the enhancements they provided, with negative effects on securities such as structured finance products and municipal bonds, and for banks and other entities and markets that rely on insurance provided by financial guarantors. Thus, the difficulties experienced by these entities have amplified downward pressures in financial markets through different channels (Schich, 2009b).

American International Group (AIG) was viewed by some observers as the world's largest insurance company, consisting of a global financial service holding company with 71 US based insurance companies and 176 other financial service companies. Although not the only insurance-dominated financial group to have sold credit default protection through derivatives, the company was special in that it was a major seller of such protection (including in the form of credit default swaps on collateralized debt obligations such as residential mortgage-backed securities) through its Financial Products unit, which was managed at the level of the groups' holding company.

Unfortunately, the risk management arrangements of the unit appeared to have been inadequate for this line of business. The risk management models initially used for this purpose did not measure the risk of future collateral calls or write-downs and more sophisticated risk management models were reportedly not effectively applied until after 2006, by which time the company had already built up most of its exposure to derivatives. In 2008, the company's Financial Product unit (AIGFP) reported a spectacular loss of around USD 10 billion for the full year 2007 and, later, an even higher loss for the first half year of 2008.

In mid-September 2008, AIG's credit rating was downgraded. As a result, the company was required

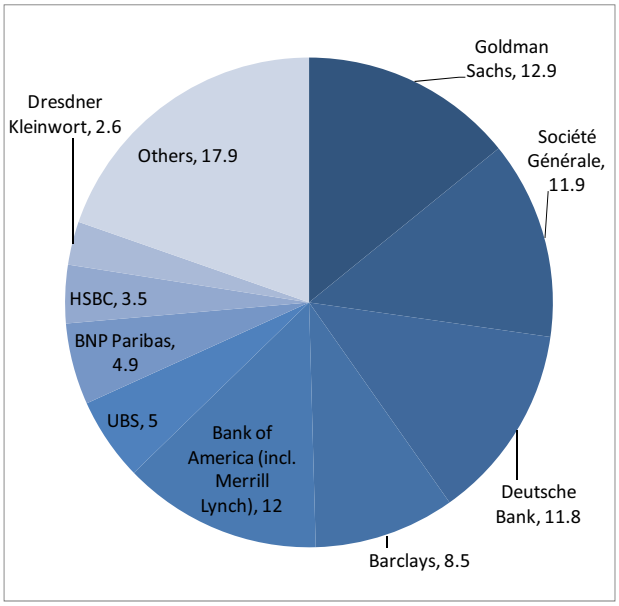
[1] A positive for insurance companies is that they are typically funded by a relatively stable flow of premiums, with very limited reliance on short-term market funding. As a result, they typically bear far less liquidity risk than commercial or investment banking firms. They are not completely immune to liquidity risk however, as rating downgrades could trigger collateral calls. Under these circumstances, liquidity risk management on the part of insurance companies is becoming an increasingly important task. Central bank and other liquidity support, as a general rule, tends not to be as readily available for insurance companies as it is for banks. The liquidity support provided to AIG was unusual in that respect. What is clear now is that liquidity risk has become a more relevant issue for some insurance companies as a result of the changes in the types of activities pursued and that, consequently, the risk management function of insurance companies (as well as the insurance regulator and supervisor) needs to pay greater attention to liquidity risks.

[2] For an overview of the industry see Singh Sisodiya and Janardhan Rao (2009).

to post a substantial amount of collateral to its counterparties[1]. But given the adverse market environment the company had difficulties in liquidating significant amounts of assets quickly enough. Thus, shortly after the company's downgrade, the U.S. government felt obliged on systemic grounds to provide a support package for AIG, agreeing to initially lend USD 85 billion in exchange for an equity stake of close to 80 per cent. The rescue package was expanded to USD 150 billion in November 2008 (and restructured again in March 2009), partly to fund an entity designed to retire credit default swap contracts by purchasing the underlying assets from CDS counterparties.

To avoid the necessity for AIG to continue to post collateral and to reduce the risk of further credit rating agency downgrades, a special purpose vehicle, Maiden Lane III purchased certain assets underlying AIGFP's CDS contracts from its counterparties. The SPV used USD 24.3 billion of central bank financing in combination with a USD 5.0 billion equity investment from AIG. The CDS counterparties agreed to terminate their CDS contracts with AIGFP in exchange for this payment; the former also were allowed to keep the USD 35 billion in collateral payments already made by AIG. Incidentally, the counterparties were effectively paid full face (or par) value of the CDS, thus an amount far above their market value at the time. This observation has been interpreted by some observers as suggesting that the terms of the deal reflected a concern on the part of public authorities for supporting AIG's counterparties, the largest of which included: Société Générale, Goldman Sachs Group Inc., Merrill Lynch, Deutsche Bank AG, UBS, Calyon Corporate and Investment Banking (a subsidiary of Crèdit Agricole S.A.), Barclays PLC, and Bank of America[2]. AIG was also involved in securities lending, and Figure 4 shows the sum of payments made to banks in relation to both AIG's CDS and securities lending activities.

Given the company's role in a wide range of financial markets, the volume of business written, and the complexity of interconnections created (especially through credit default swaps and securities lending), AIG appears to have become an important counterparty to systemically important banks. This situation has had the effect of making the company itself being considered systemically important[3]. Effectively, the capital injections and other liquidity-provision measures provided by public authorities for that company implied that this component of the financial safety net, which traditionally has had commercial banks as its prime focus, was extended to cover a wider set of financial institutions, including insurance companies. AIG was the first financial conglomerate with significant insurance operations to receive substantial US government aid before a broad-based program to help financial institutions was established[4].



Source: Estimates based on data provided in the appendices to AIG Press release, "AIG Discloses Counterparties to CDS, GIA and securities lending transactions", New York, March 15, 2009.

Fig. 4. Payments made by AIG in relation to CDS contracts and securities lending business. Sum of both types of transactions in case of each counterparty (in USD billion) since September 2008

3. Implications for the business models of insurance companies

3.1. Insurance-dominated financial groups expanding their activities beyond core business. Although the experiences in different insurance sectors differ considerably from one another, several

[1] The CDS contracts specified that (in exchange for the regular payment of insurance premiums), if the security upon which the CDS contract was written should default, AIG would be obligated to make a payout to the CDS counterparty. Also, if either the value of the securities upon which the contract was written fell or if AIG's credit rating was downgraded, AIG was obligated to provide high-quality collateral such as cash or AAA-rated securities to its counterparty.

[2] Office of the Special Inspector General for the Troubled Asset Relief Program, SIGTARP, Quarterly Report to Congress, January 30, 2010 (http://www.sigtarp.gov/embargoed/embargo.pdf).

[3] An AIG report highlights the various interlinkages and interdependencies in the financial system arising from that company's own activities (See "AIG: Is the Risk Systemic?", Draft, March 6, 2009, available http://www.aig.com/aigweb/internet/en/files/AIG%20Systemic%20Risk2_tcm385-152209.pdf).

[4] For example, only three "stand-alone insurance organizations" had received government support as of early 2009. They include AIG in the United States, AEGON N.V. in the Netherlands, and Ethias, a small Belgian insurance company. In addition, four insurers that are part of bancassurance groups – Fortis, ING Verzekeringen N.V., KBC Verzekeringen N.V and SNS REAAL – have received government financing as part of support also provided to the affiliated bank operation. See FitchRatings, "Insurance Ratings Criteria: Application in a Stressful Environment", February 10, 2009.

of them have in common that they add to a growing list of examples where the benefits to be had from revenue or risk diversification, especially in large and complex financial institutions, have been called into question. Rather negative spillovers from one part to another part of the same financial group appear to have been significant, significant enough indeed to threaten the survival of the whole financial group.

By and large, only those insurers that own banks or specialized credit insurance and other financial product units involved in providing credit protection through the writing of credit default swaps have revealed substantial exposures to the "toxic" end of the credit spectrum. For example, in the case of the company AIG, the losses from the holding company's financial products unit were so large that the benefits to be had from supposedly diversified revenue sources at the holding company level turned out to be insufficient to cover them. In the case of one large European reinsurer (Swiss Re), losses from a unit that was involved in writing credit default swaps, providing credit protection and capital market trading outweighed the profits from (well-performing) core business to be had at the consolidated level of the group. Also, somewhat similarly, in the case of the financial guarantee insurance companies, the continuation of these companies' traditional business, which was to insure municipal bonds, was rendered impossible as these companies lost their main asset (their high ratings) as a result of the large losses incurred by these entities in the more recent business line of selling credit protection related to structured financial products[1].

Given that some types of CDS are similar to insurance contracts, the involvement of insurance companies in this type of activity may not be so surprising. And clearly, credit default swaps are not a priori and in general harmful for insurance companies. That being said, at a minimum, the writing of some of them and the investing in others on the part of insurance companies highlights the need for and importance of a well functioning internal control system, risk management and corporate governance in these companies. But the more fundamental question is whether these different classes of insurance business should be combined under one roof.

[1] This situation has also increased the need for having an adequate regulatory and supervisory framework in place. As contagion risk from unregulated or lightly regulated entities within a financial group can create risks and liquidity demands for the group as a whole, it is important to ensure that this framework is comprehensive.

Research suggests that there exist different types of classes of insurance that are best not combined under one roof in the cases the entity offering insurance has no access to external capital (e.g., Russell and Jaffee, 2003; Jaffee, 2006, 2009). These authors suggest that from a capital market perspective, there is a sharp distinction between two very different classes of insurance. The first class, referred to as 'internal insurance', has the property that lines in this class are self-financing in the sense that in any one year, with a high degree of confidence, an actuarially fair premium will generate sufficient revenues to pay off the claims in that year (examples including auto insurance, standard homeowners insurance, etc.). By contrast, the second class of lines, referred to as "financial catastrophe insurance", will display high volatility since in most years there is no payout, while infrequently there is a massive payout. Since this large payout may require years of accumulated premiums, premiums which have not yet been received, writers of this line must have access to external capital. One policy implication is that, to the extent that these different types of insurance are conducted within one holding company, regulation needs to ensure that the "internal insurance" division is bankruptcy remote and can operate on a stand-alone basis if necessary even when losses from the hedge fund division threaten the holding company's solvency.

3.2. A period of de-conglomeration of complex financial groups lying ahead? In the past, different types of financial activities have often been combined under one roof and such combinations have often been defended on the grounds of the scope economies associated with the more diversified revenue stream of the group as a whole. But the weight of the empirical evidence suggests that, in crisis situations, returns in different business areas turn out to be more closely correlated (or less negatively correlated) than during normal times (e.g., Estrella, 2001; Schuermann, 2004) and, as it turns out, more so than has been expected and built into risk management models. As a consequence, the adequacy of the buffer for the group as a whole, e.g., in terms of capital cushion, tends to disappoint as well. Experiences during the last decade or so indicate that while some diversification benefits from combining banking and insurance activities in a single financial group exist, they may fall short of expectations exactly when they are needed most (Schich, 2005). The recent financial crisis has added to this list of examples.

The financial crisis is forcing insurers (and bankers) to rethink the way they do business together and, since the fall 2008, some European bancassurance

groups have either been broken up or restructured[1]. In the United States, in spring 2009, the rescue operation for AIG's holding company involved a planned break-up of the conglomerate into separate divisions. More generally, there seems to be a growing perception that a period of "de-conglomeration" or "ungrouping" may lie ahead, with an increasing separation of joint ownership of insurance, commercial and investment banking activities[2]. Such conclusions may be somewhat premature, however, and they are not borne out by recent developments, where in some cases struggling financial entities have been absorbed by and merged with other entities (often with public support), in some cases (although not in others) involving entities with traditionally different types of activities.

Such "ungrouping" may be difficult, however, once at the "financial catastrophe insurance" line of a financial group has been hit a large adverse event. In the United States, one of the largest financial guarantors has entered into a fundamental restructuring, essentially trying to separate the traditional municipal (or public finance) from the structured finance business. Currently, the company is a holding company whose subsidiaries provide financial guarantee insurance, advisory and portfolio services for the public finance and structured finance markets, and investment management services. In February 2009[3], the company announced a restructuring plan, whereby separate legal entities were created within the company, with a press release emphasizing that municipal business would be conducted by a separate operating and legal entity that "will have no exposure to structured finance business". There are, however, several lawsuits challenging this separation. While the new separate entity has been created legally, potential issuers and investors do not yet appear to view it as a risk entity separate from the legacy financial guaranty insurance entity and seem to be unwilling to do business with it until the litigation issues are resolved.

Concluding remarks

As regards the role of the insurance function in general as a shock absorber in the current crisis, it may be too early to write a proper post mortem. That said, the evidence so far suggests that there have been several stabilizing factors. Insurance companies have not generally had to sell into falling markets as a result of leverage, liquidity, regulatory and other considerations. They also have continued to write insurance business in a variety of areas, thus not only supporting economic activity in this context, but also generating premium incomes that have at least partly been re-invested in financial assets, thus supporting their prices.

Having said that, the picture is not as rosy if one zooms in on certain specific insurance sector segments. In the case of insurance segments and companies involved in the underwriting of credit risk insurance in form of credit default swaps, valuation and rating pressures have been very significant. These pressures, in turn, have tended to amplify downward pressures in financial markets. The most egregious example is afforded by the financial guarantee insurance sector, and by the deteriorating financial health of at least one large complex insurance-dominated financial group, which threatened to have systemic implications.

In large part, the caveats attached to the overall positive role that the insurance function has played in this crisis are related to the expansion of insurance-dominated financial groups into financial activities other than traditional insurance activities. For some, negative spillovers from one part (especially from the units conducting investment-bank-like activities) to another part of a financial group appear to have been significant enough to threaten the survival of the whole group.

Moreover, such structures can become overly complex and opaque. These aspects hinder the ability of supervisors and stakeholders to properly understand the risks facing an insurer, and greatly complicate the swift and orderly resolution of failed institutions. Going forward, one might speculate, there may be a premium for simplicity in institutional structures. If true, insurance companies might want to sharpen the focus on their core business.

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[1] The term bancassurance is typically used to characterize either one of two basic models. In one, which has been popular in the 1990s, banking and insurance business are combined under one roof by banks buying insurers or insurers buying banks, as well as by, for example, banks setting up insurance subsidiaries. In the other, which in a way is a less ambitious interpretation of the bancassurance model, institutions form partnerships and joint ventures in which one entity's network is used to sell another entity's products; in most cases, insurance products are sold and distributed through a bank's network. In the latter case, one entity may also acquire equity stakes in the other.

[2] See, for example, the report on an IAIS conference in "Supervisors and rating agencies blamed for crisis", in: World Insurance, Issue 849, November 3, 2008.

[3] On February 18, 2009, Municipal Bond Insurance Association Inc. (MBIA Inc.) announced that it has established a new U.S. public finance financial guarantee insurance company within the MBIA Inc. group by restructuring its principal insurance subsidiary, MBIA Insurance Corporation ("MBIA Corp.").

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