Annex 4

to response to EC consultation on the operations of the ESAs

The differences between banking and insurance

The significant differences between insurance and banking undertakings are illustrated below:

- **Business models and roles played in the economy**
  - The core activity of insurers and reinsurers is risk pooling and risk transformation. Insurers make an important contribution to economic growth by providing individuals and businesses with protection against adverse events.
  - Banks' core activities are the collection of deposits and the issuing of loans, together with the provision of a variety of fee-based services. Banks are also part of the payment and settlement system and – through their role as credit providers – they are the main transmission channel of central banks' monetary policies.
  - The upshot of these fundamental differences is that insurers tend to be less severely and abruptly affected by shocks to the economy, whereas banks are less insulated from such shocks.
- **Balance sheet structures**
  - The balance sheet of insurers is economically stable, as fairly long-term policyholder liabilities are matched with assets of corresponding duration.
  - In the case of banks, assets and liabilities are not matched, and the average duration of most bank assets is generally longer than the average duration of their liabilities.
  - The consequence of this difference is that problems can occur more suddenly for banks, whereas problems faced by insurers tend to develop over a longer period, permitting the orderly winding-up of an insurer's outstanding liabilities.
- **Risk exposures**
  - Insurance companies are mainly exposed to underwriting risk, market risk and the risk of mismatch between assets and liabilities. Importantly, the risks faced by insurers depend on both assets and liabilities and their interaction.
  - The most significant risks banks are exposed to are credit risk, liquidity risk and market risk. Assets and liabilities are very loosely interrelated as they are generated by different lines of business.
  - The most obvious consequence of these differences is that insurers have, to a larger extent than banks, some internal control over their liabilities in terms of their underwriting decisions, and, second, the ability, to some extent, to correct any mismatch between assets and liabilities. Banks on the other hand are, to a large extent, impacted by the health of the wider economy, a factor that is beyond their control.

Applying bank-inspired regulatory frameworks to insurers could have a substantial, negative impact on the insurance sector and could therefore impact the wider economy.