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Solvency 2 News, February 2021

Dear members and friends,

Given the impact of COVID-19 on the economy and on the insurance and occupational pension sectors, this year's *consumer trends report from EIOPA* focuses on the pandemic, to provide an initial and preliminary overview on the impact on the sectors, responses and the challenges which emerged. This includes taking stock as to how EIOPA's measures have been implemented and their impact.



The report only focuses on observations from Q1 and Q2 2020; hence, overall conclusions on the COVID-19 crisis cannot be drawn.

Because of the extrinsic nature of the current crisis, this year's evolutions in consumer behaviours are mostly dictated by external factors which include:

- › Forced changes in consumers' habits impacting consumers' insurance needs;
- › A deterioration of consumers' disposable income and changes in employers' cashflows; and

› Market shocks and the continued and prolonged low-interest rate environment.

Despite initial concerns, insurers, insurance intermediaries and pension funds have worked hard to guarantee business continuity.

When operational disruptions emerged, they have been isolated and not material.

Evidence from consumer interviews also confirms that business continuity has been ensured rendering the process of buying products, submitting claims and complaints or asking information as 'normal' as possible.

The sudden shift towards digital channels has crystallised some benefits of financial innovation / digitalisation both for insurers and intermediaries as well as for consumers.

However, in particular for more vulnerable and less digitally savvy consumers, intermediaries have also played a key role, being a first point of contact for consumers to seek guidance on their insurance coverage.

Given the increased digitalisation, risks relating to increased fraud both against insurance undertakings, pension funds and against consumers, members and beneficiaries have also emerged.

Looking at growth trends, at the end of Q2 2020 a majority of Member States in the EEA reported a decrease in life insurance GWP:

- › The decrease has been led by a -24.2% drop in insurance with profit participation;
- › Unit-linked insurance slightly grew, remaining the largest single line of business;
- › Considering the heterogeneous nature of the other-life insurance line of business, trends have been dictated by different factors with mortgage life insurance decreasing in several Member States, while term life insurance reported an increase.

Amidst the crisis concerns with regard to unit-linked contracts continued to persist:

- › The sharp fall in asset prices observed in March, which was accompanied by redemptions from some investment funds and a deterioration in financial market liquidity, raised some initial concerns.

› Moreover, as consumers may start to surrender their policies early, existing structural problems such as a mismatch between actual and expected returns because of the features (e.g., high risk, complex fee structure) of some unit-linked products may surface. Expected lower returns and market volatility can also further exacerbate existing problems, heightening the impact that high costs can have.

Looking at non-life insurance, the sector grew by 3.3% in the first half of 2020. Growth trends were more heterogeneous and diverse across Europe.

Amidst the crisis accident and health insurance products appear to have continued to offer valuable cover to consumers, reporting the second highest claims ratios and with no major decreases / increases in total claims incurred.

In several Member States, COVID-19 related treatments were covered and/or several initiatives, including good-will payments, have been put in place to ensure that accident and health insurance products continue to offer value to consumers.

Accident and health insurance is the product for which most good-will actions have also been reported.

The fire and other damage to property line of business increased in 26 Member States — in 4 of them by more than 15%.

Given changes in working habits and travel restrictions, at the on-set of the crisis, concerns arose with consumers possibly breaching contractual obligations and losing coverage. However, insurers showing forbearance towards consumers have been observed, albeit not in a consistent manner.

Trends in income protection insurance have varied significantly across Member States.

The unknown nature of COVID-19, in particular in relation to its long-term implications, may also lead to some changes in product design (e.g., insurers introducing exclusions or putting in place screening procedures to avoid ‘silent risks’).

The miscellaneous financial loss is the line of business which experienced the highest increase in claims ratios, more than doubling in several Member States.

This could be due to the fact that travel cancellation claims are covered under this line of business.

It could also relate to the fact that some business interruption claims may also fall under this line of business and insurers may have provisioned for expected future claims.

Concerns with regard to travel insurance products also exist. EIOPA in the past highlighted the utility of these products whilst raising concerns on the value some products bring to consumers and on some problematic business models.

The COVID-19 crisis surfaced concerns both in relation to inconsistent consumer outcomes with regard to travel insurance products and in relation to problematic business models.

Exclusions and lack of clarity in terms and conditions have raised particular challenges.

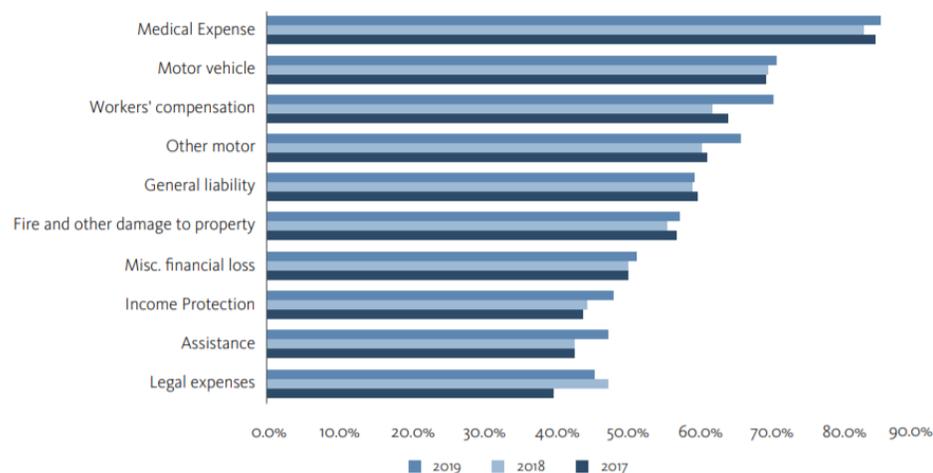
On one hand, exclusions relate to the fact that pandemics raise specific difficulties from an insurance perspective; on the other hand, increasing pressure has been put on the sector to pay out claims even though the risk may have not been originally foreseen.

To this extent at the on-set of the crisis EIOPA clearly outlined the risks of imposing retroactive coverage.

EIOPA also highlighted measures to be taken to limit possible consumer detriment, though it is not clear that these have been consistently adopted, raising concerns as to whether consumer detriment has thereby materialized.

To read more: https://www.eiopa.europa.eu/content/consumer-trends-report-2020_en

Figure 52 — Claims ratio for selected non-life insurance lines of business — 2017-2019



Source: EIOPA Solvency II database.

EIOPA publishes the second paper on the methodological principles of insurance stress testing with focus on liquidity



The European Insurance and Occupational Pensions Authority (EIOPA) published the second paper in a series of papers on the methodological principles of insurance stress testing.

The Methodological Paper is a follow-up to the consultation with stakeholders and focuses on the liquidity component. Overall, it is a further step in enhancing EIOPA's stress testing framework.

In particular, the paper sets out methodological principles that can be used to design bottom-up stress test exercises to assess the vulnerability of insurers to liquidity shocks.

The conclusions are based on the current understanding and knowledge of the liquidity risk in the insurance industry. Hence, this might evolve in the future to reflect also the experience gained in the assessment of such risk at European and global level.

Amid the increasing consideration given to liquidity risk by the insurance industry and by the supervisors at European and global level, and in the absence of a commonly adopted liquidity framework for industry in the European Union, the paper depicts a conceptual approach to the assessment of the liquidity position of insurers under adverse scenarios.

To read more: https://www.eiopa.europa.eu/content/methodological-principles-insurance-stress-testing_en

https://www.eiopa.europa.eu/sites/default/files/financial_stability/insurance_stress_test/methodological-principles-liquidity.pdf

Final Report on draft Regulatory Technical Standards



The European Supervisory Authorities (ESAs) have developed through the Joint Committee (JC) draft Regulatory Technical Standards (RTS) with regard to the content, methodologies and presentation of sustainability-related disclosures under empowerments Articles 2a, 4(6) and (7), 8(3), 9(5), 10(2) and 11(4) of Regulation (EU) 2019/2088 (hereinafter Sustainable Finance Disclosure Regulation “SFDR”).

The draft RTS text and accompanying Annexes set out proposal in these areas.

They reflect the responses to a Consultation Paper (JC 2020 16) published on 23 April 2020.

The draft RTS also contain templates for pre-contractual and periodic product disclosures that were subject to an online public survey and to two consumer testing exercises conducted in the Netherlands and Poland.

In line with the empowerment in Article 4(6) SFDR, the ESAs also sought input from the Joint Research Centre of the European Commission and the European Environment Agency as referred to in Article 4(6) SFDR.

The draft RTS relate to several disclosure obligations under the SFDR regarding the publication of:

- The details of the presentation and content of the information in relation to the principle of ‘do not significantly harm’ as set out in Article 2(17) of the SFDR consistent with the content, methodologies, and presentation of indicators in relation to adverse impacts referred to in Article 4(6) and (7) SFDR (Article 2a SFDR).
- A statement on an entity’s website of describing its due diligence policy in respect of the adverse impact of investment decisions on sustainability factors in relation to climate and other environment-related impacts (Article 4(6) SFDR) and adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters (Article 4(7) SFDR).
- Pre-contractual information on how a product with environmental or social characteristics meet those characteristics and if an index has been designated as a reference benchmark, whether and how that index is consistent with those characteristics (Article 8 SFDR).

- Pre-contractual information to show, where a product has sustainable investment objectives and
 - a) has a designated index as a reference benchmark, how that index is aligned with the sustainable investment objective and an explanation as to why and how that designated index aligned with the objective differs from a broad market index (Article 9(1) SFDR); or
 - b) if no index has been designated as a reference benchmark, an explanation on how those objectives are to be attained (Article 9(2) SFDR).
- Information on an entity's website to describe the environmental or social characteristics of financial products or the sustainable investment and the methodologies used (Article 10 SFDR).
- Information in periodic reports according to sectoral legislation specifying
 - (a) the extent to which products with environmental and/or social characteristics meet those characteristics, and
 - (b) for products with sustainable investment objectives and products which objective is a reduction in carbon emissions:
 - (i) the overall sustainability-related impact of the product by means of relevant sustainability indicators and
 - (ii) where an index has been designated as a reference benchmark, a comparison between the overall impact of the financial product with the designated index and a broad market index through sustainability indicators (Article 11 SFDR).

The draft RTS text and accompanying Annexes form the core of this Consultation Paper (Section 3).

An impact assessment and feedback statement on the consultation paper are also included in (Section 4) to highlight possible costs and benefits of the proposals and to summarise the responses received and reaction from ESAs.

Responses by the stakeholder group of ESMA and EIOPA are attached as annexes.

To read more:

<https://www.eiopa.europa.eu/sites/default/files/publications/reports/jc-2021-03-joint-esas-final-report-on-rts-under-sfdr.pdf>

Climate change and central banking

Keynote speech by Ms Christine Lagarde, President of the European Central Bank, at the ILF conference on Green Banking and Green Central Banking, Frankfurt am Main



In the famous fable "Belling the Cat", a group of mice gather to discuss how to deal with a cat that is eating them one by one.

They hatch a plan to put a bell on the cat so they can hear it coming and escape before being caught.

When it comes to who will actually do it, however, each mouse finds a reason why they are not the right mouse for the job, and why another mouse should do it instead.

The cat never does receive a bell – and the story ends poorly for the mice.

In many ways, that fable describes mankind's reaction to the threats posed by climate change.

Already in 1986, the front cover of Der Spiegel showed Cologne cathedral half-submerged by water and the headline declared a "Climate Catastrophe".

This is just one example, among many, that demonstrates that people were aware of the risks posed by climate change a generation ago.

Yet, while many people agreed on the seriousness of the issue, and that something had to be done, concrete action has been much less prevalent.

It is with this history in mind that I want to talk about the role of central banks in addressing climate change.

Clearly, central banks are not the main actors when it comes to preventing global heating.

Central banks are not responsible for climate policy and the most important tools that are needed lie outside of our mandate.

But the fact that we are not in the driving seat does not mean that we can simply ignore climate change, or that we do not play a role in combating it.

Just as with the mice in the fable, inaction has negative consequences, and the implications of not tackling climate change are already visible.

Globally, the past six years are the warmest six on record, and 2020 was the warmest in Europe.

The number of disasters caused by natural hazards is also rising, resulting in \$210 billion of damages in 2020.

An analysis of over 300 peer-reviewed studies of disasters found that almost 70% of the events analysed were made more likely, or more severe, by human-caused climate change.

That said, there are now signs that policy action to fight climate change is accelerating, especially in Europe.

We are seeing a new political willingness among regulators and fiscal authorities to speed up the transition to a carbon neutral economy, on the back of substantial technological advances in the private sector.

This increased action is often considered as a source of transition risk, which we need to take into account and reflect in our policy framework.

This is not "mission creep", it is simply acknowledging reality.

Yet the transition to carbon neutral is not so much a risk as an opportunity for the world to avoid the far more disruptive outcome that would eventually result from governmental and societal inaction.

Scenarios show that the economic and financial risks of an orderly transition can be contained.

Even a disorderly scenario, where the economic and financial impacts are potentially substantial, represents a much better overall outcome in the long run than the disastrous impact of the transition not occurring at all.

It now seems likely that faster progress will be made along three interlocking dimensions.

Each of them lies outside the remit of central banks, but will have important implications for central bank balance sheets and policy objectives.

Including, informing and innovating

The first dimension along which we expect rapid progress is including the true social and environmental cost of carbon into the prices paid by all sectors of the economy.

Appropriate pricing can come via direct carbon taxes or through comprehensive cap and trade schemes.

Both are used to some extent in the EU.

It is likely, though, that the next steps in Europe will come mainly via the EU's Emissions Trading System (ETS), a cap and trade scheme.

The ETS is an essential infrastructure, although it has not always been successful in the past at delivering a predictable price of carbon.

Moreover, it currently covers only around half of EU greenhouse gas emissions and a significant amount of allowances continue to be given for free.

The effective price of carbon is expected to rise if the EU's targets for reducing emissions are to be reached.

Modelling by the OECD and the European Commission suggests that an effective carbon price between €40–60 is currently needed, depending on how stringent other regulations are.

The introduction of the ETS Market Stability Reserve and the review of the ETS scheduled for this year should provide the opportunity to deliver a clear path towards adequate carbon pricing.

The second dimension where we expect to see progress is greater information on the exposure of individual companies.

At present, information on the sustainability of financial products – when available – is inconsistent, largely incomparable and at times unreliable.

That means that climate risks are not adequately priced, and there is a substantial risk of sharp future corrections. Yet for an open market economy to allocate resources efficiently, the pricing mechanism needs to work correctly.

This requires a step change in the disclosure of climate-related data using standardised and commonly agreed definitions.

While TCFD-based disclosures have underpinned public/private efforts to better inform, disclosure needs to be at a far more granular level of detail than is currently available.

In Europe climate disclosures are governed by the Non-Financial Reporting Directive (NFRD), which is currently under review.

The Eurosystem has advocated for mandatory disclosures of climate-related risks from a far greater number of companies, including non-listed entities.

Moreover, disclosures should be complemented by forward-looking measures that assess the extent to which both financial and non-financial firms are aligned with climate goals and net zero commitments.

The European Taxonomy Regulation that entered into force last year is also an important milestone along this path.

But it still needs to be fleshed out with concrete technical criteria and complemented by an equivalent taxonomy for carbon-intensive activities.

A further essential step is the consistent and transparent inclusion of climate risks in credit ratings. Here, again, we have high hopes that progress will now speed up.

While adequate carbon prices and greater information on exposures will help provide incentives to decarbonise, that economic transformation cannot take place without the third dimension: substantial green innovation and investment.

Both, however, require a complex ecosystem of which finance is a key element, so we expect to see increasing availability of green finance.

Green bond issuance by euro area residents has grown sevenfold since 2015, reaching €75 billion in 2020 – this represents roughly 4% of the total corporate bond issuance.

We need to see funding for green innovation increasing from other market segments as well, especially as recent analyses point to the beneficial role of equity investors in supporting the green transition.

Assets under management by investment funds with environmental, social and governance mandates have roughly tripled since 2015, and a little more than half of these funds are domiciled in the euro area.

Completing the capital markets union should provide a further push to support equity-based green finance by fostering deep and liquid capital markets across Europe.

Simultaneous progress along each of these three dimensions increases the likelihood of substantial economic change in the near term.

That is so because movement along each dimension reinforces progress along the others and magnifies the effectiveness of climate policy.

For example, the economic impact of higher carbon prices depends on the availability of alternative green technologies.

In the past, a sudden and substantial increase in carbon taxes could have resulted in an economic downturn, substantial stranded assets and threats to financial stability.

Today, however, solar power is not only consistently cheaper than new coal or gas-fired plants in most countries, but it also offers some of the lowest cost electricity ever seen.

Green finance and innovation are also developing rapidly.

Introducing well-signalled carbon pricing therefore becomes more feasible and could further sharpen incentives both to develop new technologies and to carry out the substantial investment required for the widespread adoption of the green technologies that already exist.

Climate change and central banks

Today, then, central banks face two trends – more visible impacts of climate change and an acceleration of policy transition.

Both trends have macroeconomic and financial implications and have consequences for our primary objective of price stability, for our other areas of competence including financial stability and banking supervision, as well as for the Eurosystem's own balance sheet.

Central banks are both aware of those consequences, and determined to mitigate them.

Much has already been accomplished and more is under way:

The founding of the Network for Greening the Financial System (NGFS), with membership including all major central banks, is testament to that collective engagement with climate change.

At the ECB, we are now launching a new climate change centre to bring together more efficiently the different expertise and strands of work on climate across the Bank. Climate change affects all of our policy areas.

The climate change centre provides the structure we need to tackle the issue with the urgency and determination that it deserves.

In the area of financial stability and banking supervision, the ECB has taken concrete steps towards expanding the financial system's understanding of climate risks and its ability to manage them.

We have issued a guide on our supervisory expectations relating to the management and disclosure of climate-related and environmental risks.

A recent survey of the climate-related disclosures of 125 banks suggests there is still a way to go. It evaluated climate disclosures across several basic information categories.

Only 3% of banks made disclosures in every category, and 16% made no disclosure in any category.

ECB Banking Supervision has requested that banks conduct a climate risk self-assessment and draw up action plans, which we will begin assessing this year.

We will conduct a bank-level climate stress test in 2022.

The ECB is also currently carrying out a climate risk stress test exercise to assess the impact on the European banking sector over a 30-year horizon.

Preliminary results from mapping climate patterns to the address-level location of firms' physical assets show that in the absence of a transition, physical risks in Europe are concentrated unevenly across countries and sectors of the economy.

But there is more: climate change also impacts our primary mandate of price stability through several channels. This is why climate change considerations form an integral part of our ongoing review of our monetary policy strategy.

Climate change can create short-term volatility in output and inflation through extreme weather events, and if left unaddressed can have long-lasting effects on growth and inflation.

Transition policies and innovation can also have a significant impact on growth and inflation.

These factors could potentially cause a durable divergence between headline and core measures of inflation and influence the inflation expectations of households and businesses.

The transmission of monetary policy through to the interest rates faced by households and businesses could also be impaired, to the extent that increased physical risks or the transition generate stranded assets and losses by financial institutions.

According to a recent estimate by the European Systemic Risk Board, a disorderly transition could reduce lending to the private sector by 5% in real terms.

And climate change can also have implications for our monetary policy instruments.

First, the Eurosystem's balance sheet itself is exposed to climate risks, through the securities purchased in the asset purchase programmes and the collateral provided by counterparties as part of our policy operations.

Furthermore, several factors associated with climate change may weigh on productivity and the equilibrium interest rate, potentially reducing the space available for conventional policy.

For example, labour supply and productivity may diminish as a result of heat stress, temporary incapability to work and higher rates of mortality and morbidity.

Resources may be reallocated away from productive use to support adaptation, while capital accumulation may be impaired by rising destruction from natural hazards and weaker investment dynamics related to rising uncertainty.

And the increase in short-term volatility and accelerated structural change could hamper central banks' ability to correctly identify the shocks that are relevant for the medium-term inflation outlook, making it more difficult to assess the appropriate monetary policy stance.

Our strategy review enables us to consider more deeply how we can continue to protect our mandate in the face of these risks and, at the same time, strengthen the resilience of monetary policy and our balance sheet to climate risks.

That naturally involves evaluating the feasibility, efficiency and effectiveness of available options, and ensuring they are consistent with our mandate.

The ECB is also assessing carefully, without prejudice to the primary objective of price stability, how it can contribute to supporting the EU's economic policies, as required by the treaty.

Europe has prioritised combating climate change and put in place targets, policies and regulations to underpin the transition to a carbon-neutral economy.

While the Eurosystem is not a policy maker in these areas, it should assess its potential role in the transition.

We recognise that our active role in some markets can influence the development of certain market segments. The ECB currently holds around a fifth of the outstanding volume of eligible green bonds.

Standardisation helps nascent markets gain liquidity and encourages growth. And our eligibility criteria can provide, in this context, a useful coordination device.

For example, since the start of this year, bonds with coupon structures linked to certain sustainability performance targets have been eligible as collateral for Eurosystem credit operations and for outright purchases for monetary policy purposes.

We have also taken action with regards to our non-monetary policy portfolio, namely our own funds and pension fund.

The ECB raised the share of green bonds in its own funds portfolio to 3.5% last year and is planning on raising it further as this market is expected to grow in the coming years.

Investing parts of the own funds portfolio in the green bond fund of the Bank for International Settlements marks another step in this direction.

A shift of all conventional equity benchmark indices tracked by the staff pension fund to low-carbon equivalents last year significantly reduced the carbon footprint of the equity funds. Other central banks are also aligning decisively their investment decisions with sustainability criteria.

Conclusion

Let me conclude.

Climate change is one of the greatest challenges faced by mankind this century, and there is now broad agreement that we should act. But that agreement needs to be translated more urgently into concrete measures.

The ECB will contribute to this effort within its mandate, acting in tandem with those responsible for climate policy.

Unlike the mice in the fable, not only do we have to recognise that we cannot keep waiting for someone else to act, we also must recognise that the burden cannot fall on one party alone.

There is no single panacea for climate change, and combating it requires rapid progress along several dimensions.

Relying on just one solution, or on one party, will not be enough to avoid a climate catastrophe. And here we can actually learn something from mice. As the Roman playwright Plautus wrote, "How wise a beast is the little mouse, who never entrusts its safety to only one hole."

FSB Work Programme for 2021



The Financial Stability Board's (FSB) work programme for 2021 reflects a strategic shift in priorities in the COVID-19 environment.

The work programme aims to maximise the value of FSB work to foster global financial stability while preserving the capacity for the FSB to respond to new issues that may emerge.

The FSB will reinforce its forward-looking monitoring of developments to identify, assess and address new and emerging risks to global financial stability, and continue to assess the functioning of the regulatory framework put in place after the 2008 global financial crisis.

This note summarises the ongoing and planned FSB initiatives in 2021 organised by:

- (1) priority areas of work and new initiatives;
- (2) work programme items that are continuing or reaching completion; and
- (3) regular monitoring and reporting.

The Annex provides an indicative timeline of the FSB's publication planned for 2021.

Date	Report	Comment
February	Country peer review of Indonesia	
March	Country peer review of the United Kingdom	
April	Factors to be considered to prepare for an orderly unwinding of COVID-19 support measures	G20 deliverable
	Final report of the evaluation of TBTF reforms for banks	G20 deliverable
May	Quantitative targets for cross-border payments roadmap: Consultative document	
June	Practices paper for operationalising bail-in execution	

July	Policy proposals to enhance MMF resilience: Consultative report	G20 deliverable
	Lessons learnt from the COVID Event: Interim report	G20 deliverable
	Report on availability of data on climate-related financial stability risks and data gaps	G20 deliverable
	Promotion of globally comparable, high quality and auditable standards of disclosure in sustainability reporting	G20 deliverable
	Progress report on implementation of benchmark reform	G20 deliverable
October	Policy proposals to enhance MMF resilience: Final report	G20 deliverable
	Report on progress in the NBF1 work programme	G20 deliverable
	Annual report on implementation and effects of financial regulatory reforms	G20 deliverable
	Lessons learnt from the COVID Event: Final report	G20 deliverable
	Progress report on the regulation, supervision and oversight of global stablecoins	G20 deliverable
	Report on cyber incident reporting	G20 deliverable
	Quantitative targets for cross-border payments roadmap: Final report	G20 deliverable
	Progress report on implementation of the cross-border payments roadmap	G20 deliverable
November	Identification of G-SIBs for 2021	
	2021 Resolution Report	
December	Annual Global Monitoring Report on NBF1	
	Report on financial resources for CCP resolution	

1. Priority areas of work and new initiatives

Supporting international cooperation and coordination on the COVID-19 response.

The FSB, with its broad and diverse membership of national authorities, international standard setters and international bodies, continues to promote financial stability during market stress related to COVID-19.

This work will continue to include: assessments of vulnerabilities in the global financial system; sharing information on policy responses; assessing their effectiveness and coordinating the future timely unwinding of the temporary measures taken; and monitoring, with the standardsetting bodies (SSBs), the use of flexibility and consistency of policy responses with existing international financial standards.

- Work on COVID-19 responses will continue in a flexible mode, including on specific COVID-19 related vulnerabilities and policy issues, and be adjusted as needed.
- As a new project, the FSB will work with SSBs to assess initial lessons learnt from COVID-19 for financial stability, and report them to the G20.

Enhancing the resilience of the non-bank financial intermediation (NBFi) sector, while preserving its benefits.

The FSB's holistic review of the March market turmoil¹ lays out a comprehensive and ambitious work programme for strengthening the resilience of NBFi.

The FSB will coordinate and oversee work on NBFi under this programme for 2021 and beyond, which will be carried out within the FSB as well as by SSBs and international organisations over the next two years.

- Work in 2021 will focus on the specific issues identified in the holistic review, including money market funds (MMFs), open-ended funds, margining practices, liquidity, structure and resilience of core bond markets, and cross-border USD funding. The FSB will also launch an evaluation on the effects of G20 financial reforms on bond market liquidity.
- Key deliverables under the NBFi work programme in 2021 are policy proposals to enhance MMF resilience and a report on progress in the work programme for strengthening NBFi resilience.

To read more: <https://www.fsb.org/wp-content/uploads/P200121.pdf>

Cybersecurity to the Rescue: Pseudonymisation for Personal Data Protection

ENISA's new report explores pseudonymisation techniques and use cases for healthcare and information sharing in cybersecurity



Pseudonymisation is an established and accepted data protection measure that has gained additional attention following the adoption of the General Data Protection Regulation (GDPR) where it is both specifically defined and many times referenced as a safeguard.

ENISA, in its prior work on this field, has explored the notion and scope of data pseudonymisation, while presenting some basic technical methods and examples to achieve pseudonymisation in practice.

In this new report, ENISA complements its past work by discussing advanced pseudonymisation techniques, as well as specific use cases from the specific sectors of healthcare and cybersecurity.

In particular, the report, building on the basic pseudonymisation techniques, examines advanced solutions for more complex scenarios that can be based on asymmetric encryption, ring signatures and group pseudonyms, chaining mode, pseudonyms based on multiple identifiers, pseudonyms with proof of knowledge and secure multi-party computation.

It then applies some of these techniques in the area of healthcare to discuss possible pseudonymisation options in different example cases, while also exploring the possible application of the data custodianship model.

Lastly, it examines the application of basic pseudonymisation techniques in common cybersecurity use cases, such as the use of telemetry and reputation systems.

Based on the analysis provided in the report, the following basic conclusions and recommendations for all relevant stakeholders are provided.

Defining the best possible technique

As it has been stressed also in past ENISA's reports, there is no fit-for-all pseudonymisation technique and a detailed analysis of the case in question is necessary in order to define the best possible option. To do so, it is essential to take a critical look into the semantics (the "full picture") before conducting data pseudonymisation.

In addition, pseudonymisation is only one possible technique and must be combined with a thorough security risk assessment for the protection of personal data.

Data controllers and processors should engage in data pseudonymisation, based on a security and data protection risk assessment and taking due account of the overall context and characteristics of personal data processing.

This may also comprise methods for data subjects to pseudonymise personal data on their side (e.g. before delivering data to the controller/processor) to increase control of their own personal data.

Regulators (e.g. Data Protection Authorities and the European Data Protection Board) should promote risk-based data pseudonymisation through the provision of relevant guidance and examples.

Advanced techniques for advanced scenarios

While the technical solution is a critical element for achieving proper pseudonymisation, one must not forget that the organisational model and its underlying structural architecture are also very important parameters of success.

Advanced techniques go together with advanced scenarios, such as the case of the data custodianship model.

Data controllers and processors should consider possible scenarios that can support advanced pseudonymisation techniques, based – among other – on the principle of data minimisation.

The research community should support data controllers and processors in identifying the necessary trust elements and guarantees for the advanced scenarios (e.g. data custodianship) to be functional in practice.

Regulators (e.g. Data Protection Authorities and the European Data Protection Board) should ensure that regulatory approaches, e.g. as regards new technologies and application sectors, take into account all possible entities and roles from the standpoint of data protection, while remaining technologically neutral.

Establishing the state-of-the-art

Although a lot of work is already in place, there is certainly more to be done in defining the state-of-the-art in data pseudonymisation.

To this end, research and application scenarios must go hand-in-hand, involving all relevant parties (researchers, industry, and regulators) to discuss joined approaches.

The European Commission, the relevant EU institutions, as well as Regulators (e.g. Data Protection Authorities and the European Data Protection Board) should support the establishment and maintenance of the state-of-the-art in pseudonymisation, bringing together all relevant stakeholders in the field (regulators, research community, and industry).

The research community should continue its efforts on advancing the existing work on data pseudonymisation, addressing special challenges appearing from emerging technologies, such as Artificial Intelligence.

The European Commission and the relevant EU institutions should support and disseminate these efforts.

Towards the broader adoption of data pseudonymisation

Recent developments, e.g. in international personal data transfers, show clearly the need to further advance appropriate safeguards for personal data protection.

This will only be intensified in the future by the use of emerging technologies and the need for open data access.

It is, thus, important to start today the discussion on the broader adoption of pseudonymisation in different application scenarios.

Regulators (e.g. Data Protection Authorities and the European Data Protection Board), the European Commission and the relevant EU institutions should disseminate the benefits of data pseudonymisation and provide for best practices in the field.

To read more: <https://www.enisa.europa.eu/publications/data-pseudonymisation-advanced-techniques-and-use-cases>

On the origin of systemic risk

Staff Working Paper No. 906 - by Mattia Montagna, Gabriele Torri and Giovanni Covi.



BANK OF ENGLAND

Abstract

Systemic risk in the banking sector is usually associated with long periods of economic downturn and very large social costs.

On one hand, shocks coming from correlated exposures towards the real economy may induce correlation in banks' default probabilities thereby increasing the likelihood for systemic tail events like the 2008 Great Financial Crisis.

On the other hand, financial contagion also plays an important role in generating large-scale market failures, amplifying the initial shocks coming from the real economy.

To study the sources of these rare phenomena, we propose a new definition of systemic risk (ie the probability of a large number of banks going into distress simultaneously) and thus we develop a multilayer microstructural model to study empirically the determinants of systemic risk.

The model is then calibrated on the most comprehensive granular dataset for the euro-area banking sector, capturing roughly 96% or €23.2 trillion of euro-area banks' total assets over the period 2014–2018.

The outputs of the model decompose and quantify the sources of systemic risk showing that correlated economic shocks, financial contagion mechanisms, and their interaction are the main sources of systemic events.

The results obtained with the simulation engine resemble common market-based systemic risk indicators and empirically corroborate findings from existing literature.

This framework gives regulators and central bankers a tool to study systemic risk and its developments, pointing out that systemic events and banks' idiosyncratic defaults have different drivers, hence implying different policy responses.

Introduction

The 2008 Great Financial Crisis revealed, once again, the endogenous instability of our economic and financial system.

Size, interconnectedness, opacity and complexity were among the traits of the financial industry which caused a real economic shock to become a systemic financial event, where a very large number of banks and other financial institutions world-wide were affected with large social and public costs.

A core message has been indeed that financial stability can't be analyzed by looking at banks in isolation, but instead must be observed as intrinsically related to the micro structure of the financial system and its connection to the real economy.

When studying systemic risk, it is therefore necessary to have an holistic view of the financial system to encompass the internal and external feedback dynamics at the very core of financial systemic events.

As those feedbacks have been proven to be driven by the way financial institutions interact with each other and the real economy, it is necessary to have microstructural a model to reproduce financial crisis.

Nevertheless, despite the growing interest, the concept of systemic risk remains difficult to measure and quantify (Hansen, 2012).

Several theoretical frameworks have been proposed to assess systemic risk.

Some focus on measuring tail interdependence between assets market indices (e.g. Acharya et al., 2017; Adrian and Brunnermeier, 2016) or on gauging the risk stemming from interconnectedness (Billio et al., 2012; Diebold and Yilmaz, 2008). Other models encompass the multidimensionality of systemic risk by aggregating multiple market indicators to assess the level of stress in the system (Hollo et al., 2012; Committee, 2011).

Finally, an increasingly popular class of models use microstructural approaches in which interactions among agents are individually modelled, in order to describe the evolution of a complex system and to study the diffusion of financial contagion via multiple channels in reaction to an exogenous initial shock (see e.g. Allen and Gale, 2000; Gai and Kapadia, 2010; Acemoglu et al., 2012; Montagna and Kok, 2016).

To read more: <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2021/on-the-origin-of-systemic-risk.pdf?la=en&hash=65ACCEE42828B7EDO4046E296A8E7BAF37A0E72C>



BANK OF ENGLAND

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On the origin of systemic risk

Mattia Montagna, Gabriele Torri and Giovanni Covi

The sovereign-bank-corporate nexus – virtuous or vicious?

Isabel Schnabel, Member of the Executive Board of the European Central Bank, at the LSE conference on Financial Cycles, Risk, Macroeconomic Causes and Consequences, Frankfurt am Main.



One year after the first cases were reported in Europe, the coronavirus (COVID-19) pandemic continues to take a tragic human toll and to pose enormous challenges to workers, firms, the financial system and policymakers in the euro area.

Without the forceful responses of fiscal, monetary and prudential authorities the economic and social costs of this crisis would have been significantly higher.

Governments, in particular, have stabilized aggregate demand and incomes by absorbing economic and financial risks of the private sector as the crisis unfolded.

Through the generous issuance of guarantee schemes, governments secured a continuous flow of credit to firms, which supported economic growth and protected financial stability.

Monetary policy has complemented these efforts by providing ample liquidity and restoring favourable financing conditions.

As a consequence, the policy response to the pandemic has visibly intensified the interdependencies between sovereigns, banks and firms. It has created a “sovereign-bank-corporate” nexus.

In my remarks today, I will argue that the extent to which such interdependencies may create challenges in the future depends, to a large extent, on the types of feedback loops they create.

Broad fiscal and monetary policy support today minimise the realisation of contingent liabilities in the future, and thus limit the scarring effects of the pandemic on the economy, creating a virtuous circle.

So, contrary to the vicious “sovereign-bank” nexus that plagued the euro area throughout most of the last decade, the current nexus, if managed

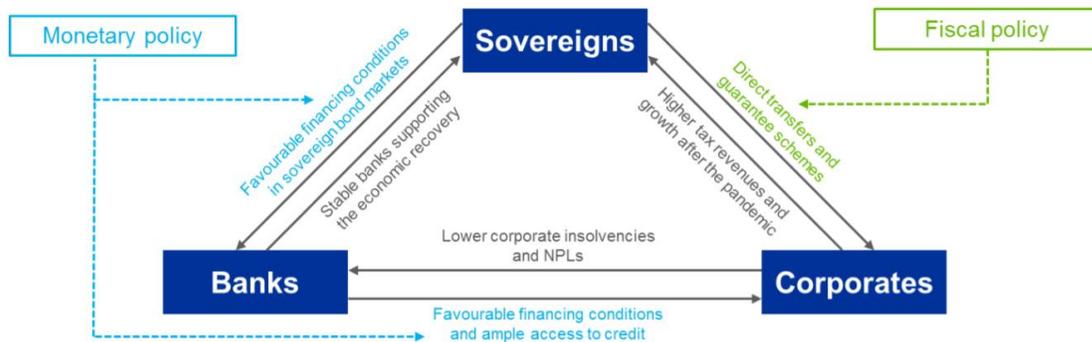
properly, can be an engine for a faster recovery, which also supports the ECB's price stability mandate.

A virtuous circle between sovereigns, banks and corporates

At the onset of the pandemic, the strict lockdown measures hit large parts of the corporate sector hard, raising its vulnerability to levels last seen during the global financial crisis (Chart 1).

Many firms saw their revenues collapse and were facing acute liquidity shortages that threatened to turn into solvency problems.

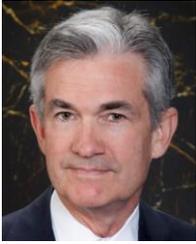
To read more: <https://www.bis.org/review/r210129b.pdf>



Source: ECB.

Getting Back to a Strong Labor Market

Chair Jerome H. Powell, Chair of the Board of Governors of the Federal Reserve System, at the Economic Club of New York.

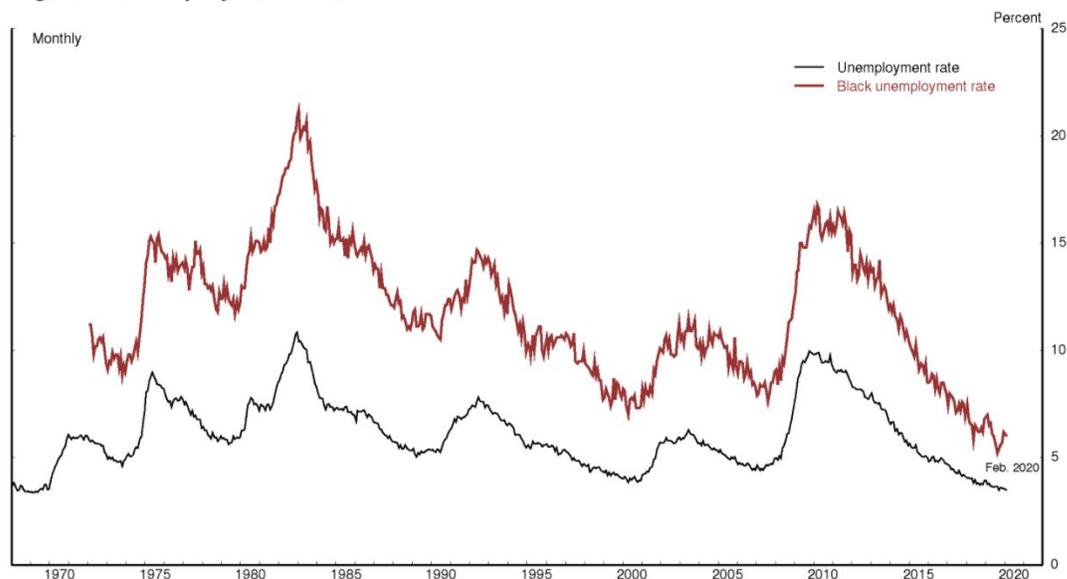


Today I will discuss the state of our labor market, from the recent past to the present and then over the longer term. A strong labor market that is sustained for an extended period can deliver substantial economic and social benefits, including higher employment and income levels, improved and expanded job opportunities, narrower economic disparities, and healing of the entrenched damage inflicted by past recessions on individuals' economic and personal well-being.

At present, we are a long way from such a labor market. Fully realizing the benefits of a strong labor market will take continued support from both near-term policy and longer-run investments so that all those seeking jobs have the skills and opportunities that will enable them to contribute to, and share in, the benefits of prosperity.

The Labor Market of a Year Ago

Figure 1. Unemployment Rate



Note: Published data on unemployment rates by race start in 1972.
Source: Bureau of Labor Statistics.

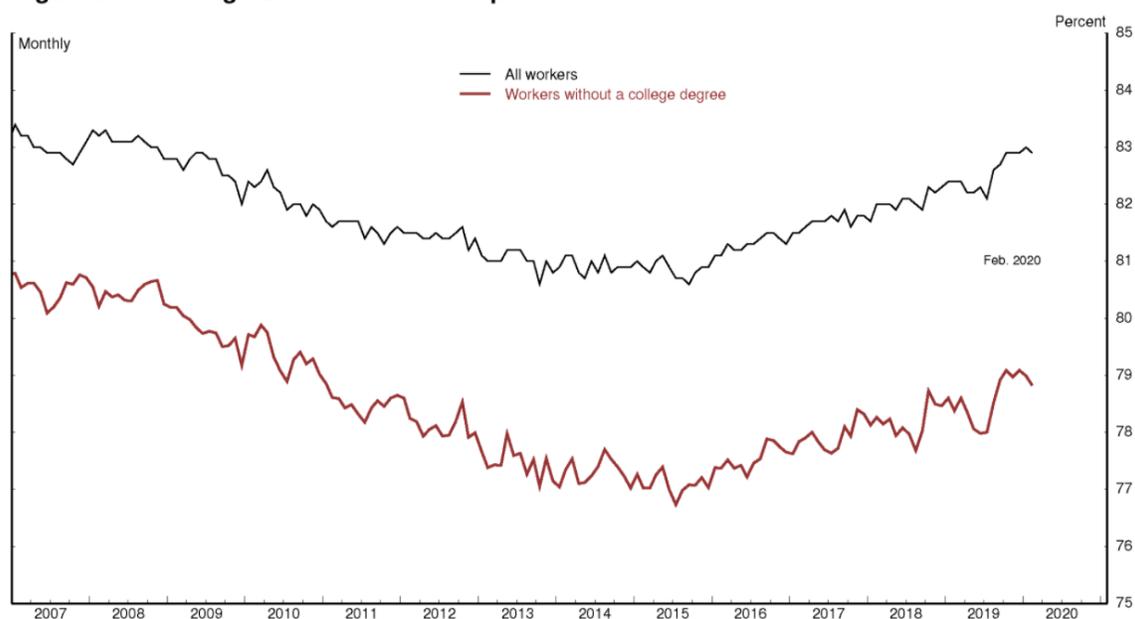
We need only look to February of last year to see how beneficial a strong labor market can be. The overall unemployment rate was 3.5 percent, the lowest level in a half-century. The unemployment rate for African

Americans had also reached historical lows (figure 1). Prime-age labor force participation was the highest in over a decade, and a high proportion of households saw jobs as "plentiful."

Overall wage growth was moderate, but wages were rising more rapidly for earners on the lower end of the scale. These encouraging statistics were reaffirmed and given voice by those we met and conferred with, including the community, labor, and business leaders; retirees; students; and others we met with during the 14 Fed Listens events we conducted in 2019.

Many of these gains had emerged only in the later years of the expansion. The labor force participation rate, for example, had been steadily declining from 2008 to 2015 even as the recovery from the Global Financial Crisis unfolded.

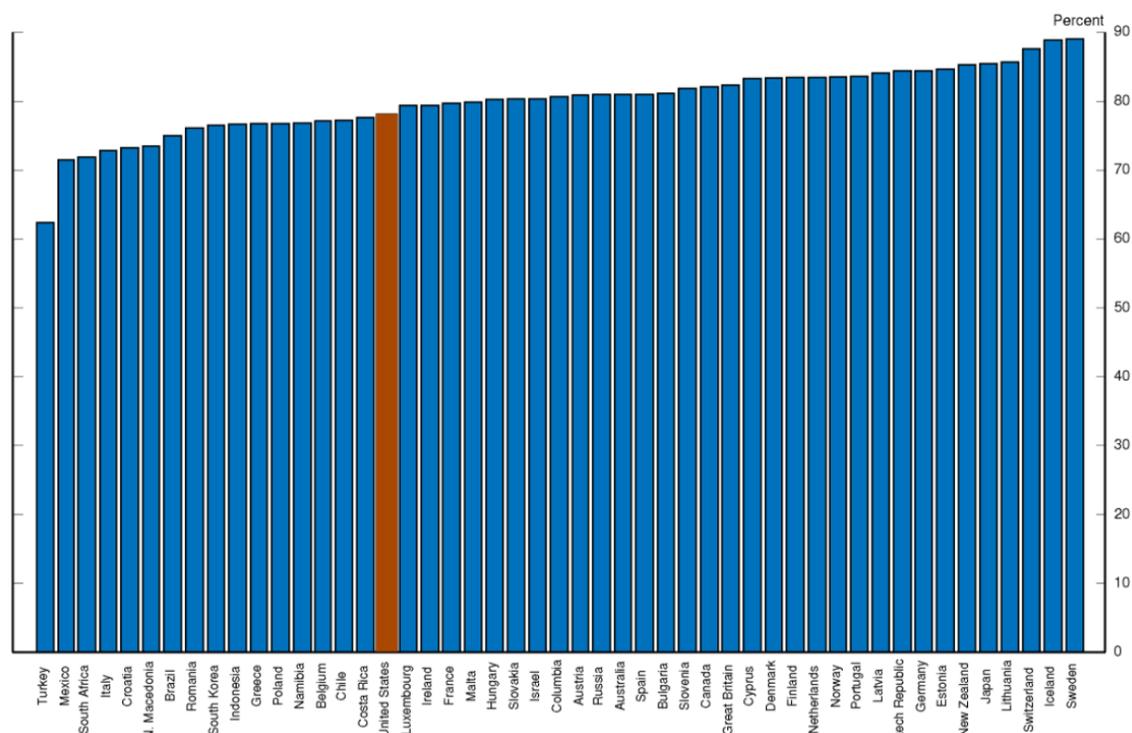
Figure 2. Prime-Age Labor Force Participation



Note: Prime age refers to ages 25 to 54.
Source: Bureau of Labor Statistics and Board staff calculations using microdata from the Current Population Survey.

In fact, in 2015, prime-age labor force participation—which I focus on because it is not significantly affected by the aging of the population—reached its lowest level in 30 years even as the unemployment rate declined to a relatively low 5 percent. Also concerning was that much of the decline in participation up to that point had been concentrated in the population without a college degree (figure 2).

Figure 3. Labor Force Participation Rate in OECD Countries: 25-64 Year Olds, 2019



Note: OECD is Organisation for Economic Co-operation and Development.
 Source: OECD (2021), "Labour force participation rate" (indicator), <https://doi.org/10.1787/8a801325-en> (accessed on February 1, 2021).

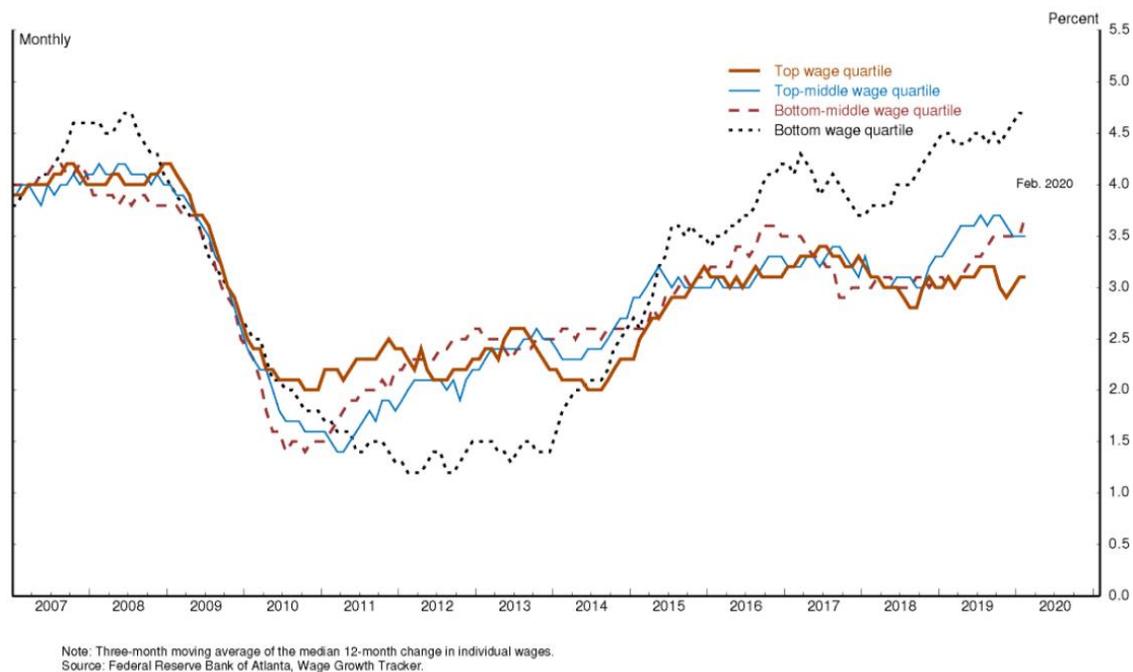
At the time, many forecasters worried that globalization and technological change might have permanently reduced job opportunities for these individuals, and that, as a result, there might be limited scope for participation to recover.

Fortunately, the participation rate after 2015 consistently outperformed expectations, and by the beginning of 2020, the prime-age participation rate had fully reversed its decline from the 2008-to-2015 period.

Moreover, gains in participation were concentrated among people without a college degree. Given that U.S. labor force participation has lagged relative to other advanced economy nations, this progress was especially welcome (figure 3).

As I mentioned, we also saw faster wage growth for low earners once the labor market had strengthened sufficiently. Nearly six years into the recovery, wage growth for the lowest earning quartile had been persistently modest and well below the pace enjoyed by other workers.

At the tipping point of 2015, however, as the labor market continued to strengthen, the trend reversed, with wage growth for the lowest quartile consistently and significantly exceeding that of other workers (figure 4).

Figure 4. Wage Growth for Low Earners Compared with Other Workers

At the end of 2015, the Black unemployment rate was still quite elevated, at 9 percent, despite the relatively low overall unemployment rate. But that disparity too began to shrink; as the expansion continued beyond 2015, Black unemployment reached a historic low of 5.2 percent, and the gap between Black and white unemployment rates was the narrowest since 1972, when data on unemployment by race started to be collected. Black unemployment has tended to rise more than overall unemployment in recessions but also to fall more quickly in expansions.

Over the course of a long expansion, these persistent disparities can decline significantly, but, without policies to address their underlying causes, they may increase again when the economy ultimately turns down.

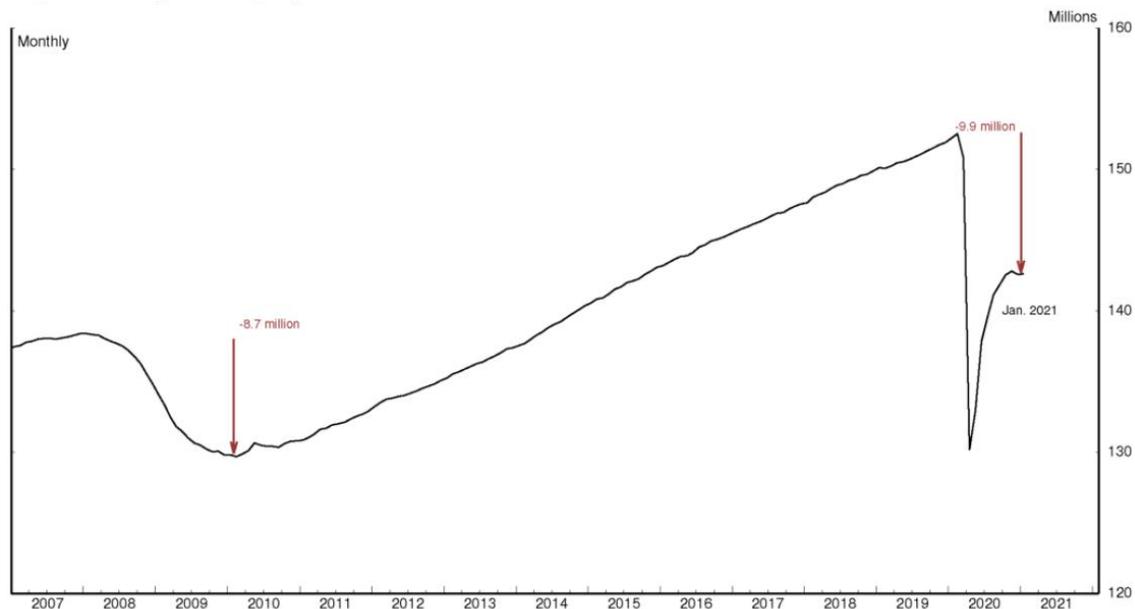
These late-breaking improvements in the labor market did not result in unwanted upward pressures on inflation, as might have been expected; in fact, inflation did not even rise to 2 percent on a sustained basis. There was every reason to expect that the labor market could have strengthened even further without causing a worrisome increase in inflation were it not for the onset of the pandemic.

The Labor Market Today

The state of our labor market today could hardly be more different. Despite the surprising speed of recovery early on, we are still very far from a strong labor market whose benefits are broadly shared. Employment in January

of this year was nearly 10 million below its February 2020 level, a greater shortfall than the worst of the Great Recession's aftermath (figure 5).

Figure 5. Payroll Employment



Note: Red arrows indicate the peak-to-trough change in employment during the Great Recession and the decline in employment from February 2020 to January 2021.
Source: Bureau of Labor Statistics.

After rising to 14.8 percent in April of last year, the published unemployment rate has fallen relatively swiftly, reaching 6.3 percent in January. But published unemployment rates during COVID have dramatically understated the deterioration in the labor market.

Most importantly, the pandemic has led to the largest 12-month decline in labor force participation since at least 1948. Fear of the virus and the disappearance of employment opportunities in the sectors most affected by it, such as restaurants, hotels, and entertainment venues, have led many to withdraw from the workforce. At the same time, virtual schooling has forced many parents to leave the work force to provide all-day care for their children.

All told, nearly 5 million people say the pandemic prevented them from looking for work in January. In addition, the Bureau of Labor Statistics reports that many unemployed individuals have been misclassified as employed. Correcting this misclassification and counting those who have left the labor force since last February as unemployed would boost the unemployment rate to close to 10 percent in January (figure 6).

Unfortunately, even those grim statistics understate the decline in labor market conditions for the most economically vulnerable Americans. Aggregate employment has declined 6.5 percent since last February, but the decline in employment for workers in the top quartile of the wage

distribution has been only 4 percent, while the decline for the bottom quartile has been a staggering 17 percent (figure 7).

Figure 6. Official and Alternative Unemployment Rates

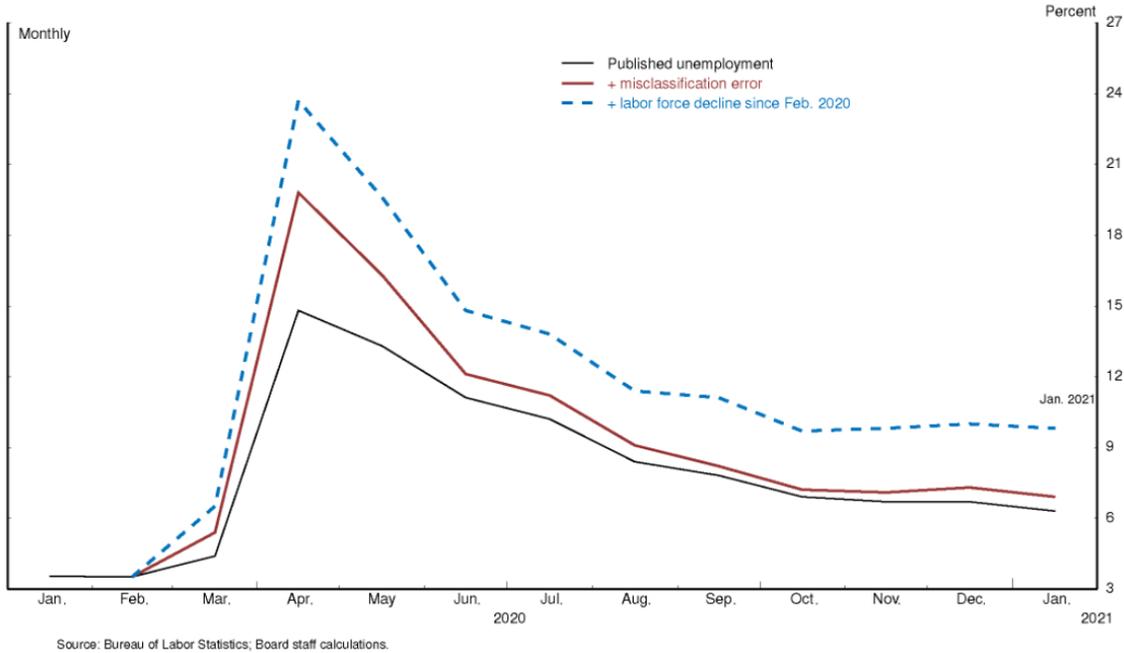
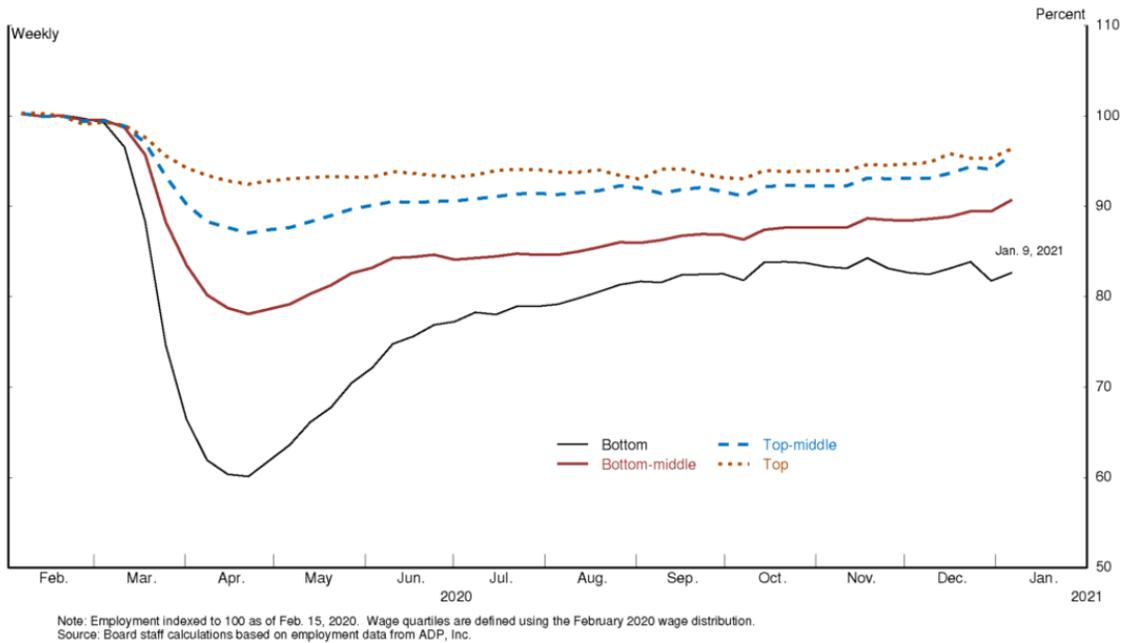


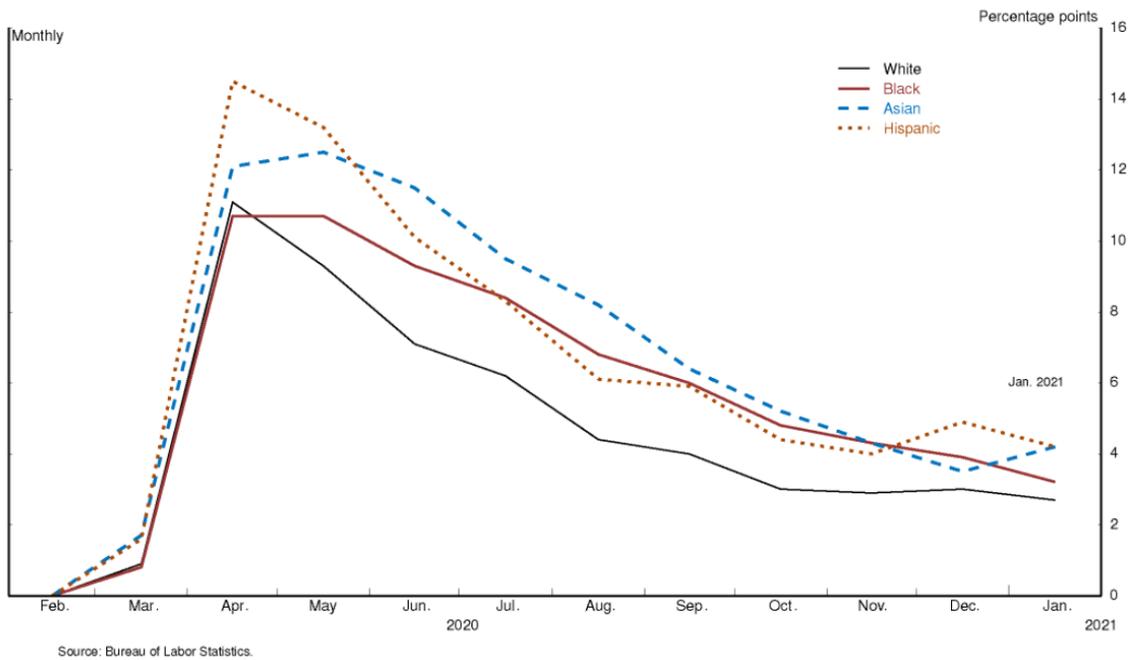
Figure 7. Employment by Wage Quartile



Moreover, employment for these workers has changed little in recent months, while employment for the higher-wage groups has continued to improve. Similarly, the unemployment rates for Blacks and Hispanics have risen significantly more than for whites since February 2020 (figure 8). As

a result, economic disparities that were already too wide have widened further.

Figure 8. Change in Unemployment Rate by Race/Ethnicity since February 2020

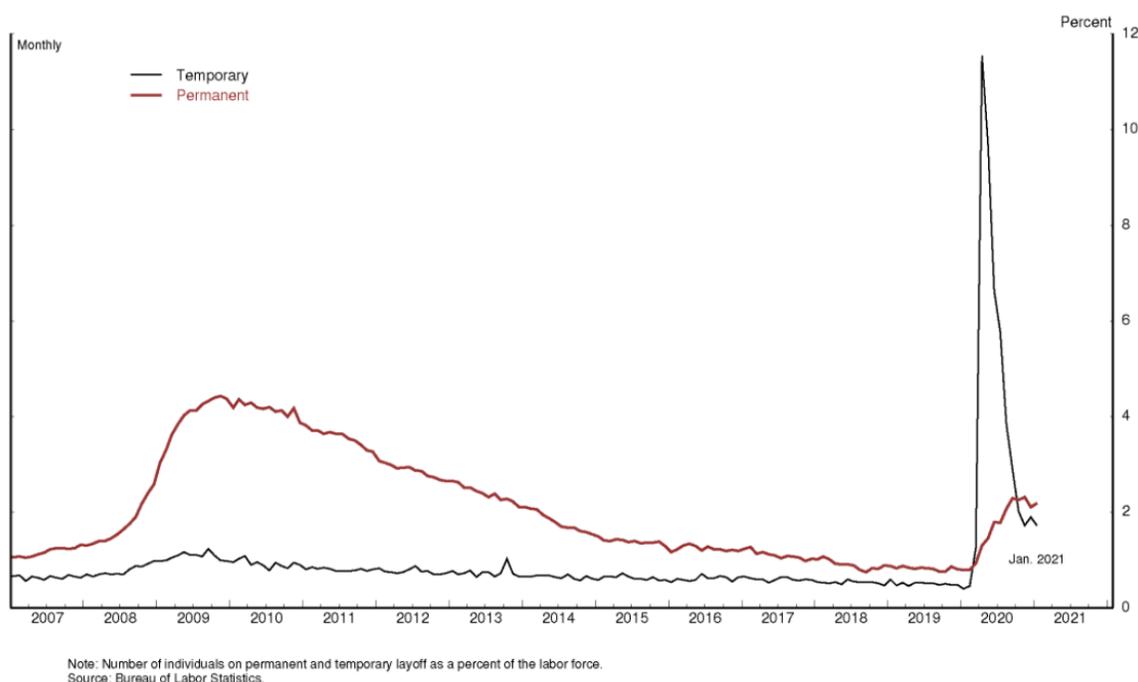


In the past few months, improvement in labor market conditions stalled as the rate of infections sharply increased. In particular, jobs in the leisure and hospitality sector dropped over 1/2 million in December and a further 61,000 in January. The recovery continues to depend on controlling the spread of the virus, which will require mass vaccinations in addition to continued vigilance in social distancing and mask wearing in the meantime.

Since the onset of the pandemic, we have been concerned about its longer-term effects on the labor market. Extended periods of unemployment can inflict persistent damage on lives and livelihoods while also eroding the productive capacity of the economy. And we know from the previous expansion that it can take many years to reverse the damage.

At the start of the pandemic, the increase in unemployment was almost entirely due to temporary job losses.

Temporarily laid-off workers tend to return to work much more quickly, on average, than those whose ties to their former employers are permanently severed. But as some sectors of the economy have continued to struggle, permanent job loss has increased (figure 9).

Figure 9. Permanent and Temporary Layoffs

So too has long-term unemployment. Still, as of January, the level of permanent job loss, as a fraction of the labor force, was considerably smaller than during the Great Recession. Research shows that the Paycheck Protection Program has played an important role in limiting permanent layoffs and preserving small businesses. The renewal of the program this year in the face of another surge in COVID-related job cuts is an encouraging development.

Of course, in a healthy market-based economy, perpetual churn will always render some jobs obsolete as they are replaced by new employment opportunities. Over time, workers and capital move from firm to firm and from sector to sector. It is likely that the pandemic has both increased the need for such movements and brought forward some movement that would have occurred eventually.

Getting Back to a Strong Labor Market

So how do we get from where we are today back to a strong labor market that benefits all Americans and that starts to heal the damage already done? And what can we do to sustain those benefits over time? Experience tells us that getting to and staying at full employment will not be easy. In the near term, policies that bring the pandemic to an end as soon as possible are paramount. In addition, workers and households who struggle to find their place in the post-pandemic economy are likely to need

continued support. The same is true for many small businesses that are likely to prosper again once the pandemic is behind us.

Also important is a patiently accommodative monetary policy stance that embraces the lessons of the past—about the labor market in particular and the economy more generally. I described several of those important lessons, as well as our new policy framework, at the Jackson Hole conference last year.

I have already mentioned the broad-based benefits that a strong labor market can deliver and noted that many of these benefits only arose toward the end of the previous expansion. I also noted that these benefits were achieved with low inflation. Indeed, inflation has been much lower and more stable over the past three decades than in earlier times.

In addition, we have seen that the longer-run potential growth rate of the economy appears to be lower than it once was, in part because of population aging, and that the neutral rate of interest—or the rate consistent with the economy being at full employment with 2 percent inflation—is also much lower than before.

A low neutral rate means that our policy rate will be constrained more often by the effective lower bound. That circumstance can lead to worse economic outcomes—particularly for the most economically vulnerable Americans.

To take these economic developments into account, we made substantial revisions to our monetary policy framework, as described in the FOMC's Statement on Longer-Run Goals and Monetary Policy Strategy.

This revised statement shares many features with its predecessor, including our view that longer-run inflation of 2 percent is most consistent with our mandate to promote maximum employment and price stability. But it also has some innovations.

The revised statement emphasizes that maximum employment is a broad and inclusive goal. This change reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities.

Recognizing the economy's ability to sustain a robust job market without causing an unwanted increase in inflation, the statement says that our policy decisions will be informed by our "assessments of the shortfalls of employment from its maximum level" rather than by "deviations from its maximum level."

This means that we will not tighten monetary policy solely in response to a strong labor market. Finally, to counter the adverse economic dynamics that could ensue from declines in inflation expectations in an environment where our main policy tool is more frequently constrained, we now explicitly seek to achieve inflation that averages 2 percent over time.

This means that following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time in the service of keeping inflation expectations well anchored at our 2 percent longer-run goal.

Our January postmeeting statement on monetary policy implements this new framework. In particular, we expect that it will be appropriate to maintain the current accommodative target range of the federal funds rate until labor market conditions have reached levels consistent with maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.

In addition, we will continue to increase our holdings of Treasury securities and agency mortgage-backed securities by \$80 billion and \$40 billion per month, respectively, until substantial further progress has been made toward our maximum-employment and price-stability goals.

The Broad Responsibility for Achieving Maximum Employment
Seventy-five years ago, in the wake of WWII, the United States faced the challenge of reemploying millions amid a major restructuring of the economy toward peacetime ends.

Part of Congress's response was the Employment Act of 1946, which states that "it is the continuing policy and responsibility of the federal government to use all practicable means . . . to promote maximum employment."

As later amended in the Humphrey-Hawkins Act, this provision formed the basis of the employment side of the Fed's dual mandate. My colleagues and I are strongly committed to doing all we can to promote this employment goal.

Given the number of people who have lost their jobs and the likelihood that some will struggle to find work in the post-pandemic economy, achieving and sustaining maximum employment will require more than supportive monetary policy. It will require a society-wide commitment, with contributions from across government and the private sector.

The potential benefits of investing in our nation's workforce are immense. Steady employment provides more than a regular paycheck. It also bestows a sense of purpose, improves mental health, increases lifespans, and benefits workers and their families.

I am confident that with our collective efforts across the government and the private sector, our nation will make sustained progress toward our national goal of maximum employment.

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