Risk-based supervision in the Netherlands using FIRM

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Aspects of risk-based supervision

- Risk-based solvency rule
- Requirements for risk management
- Risk-scoring model (FIRM)
- Organisation of supervisor
Driving factors in adopting risk-based supervision

- Increasing complexity of instruments and markets
- Efficient use of supervisory resources
- Reduce risk of underfunding (Vie d’Or failure in 1993, stock market crash in early 2000s)
- Spill-over from methods applied to banking sector (in integrated supervisor)
Financial Assessment Framework for pension funds

- Market valuation of assets and liabilities
- Short-term solvency test
- Long-term continuity analysis
- Specified recovery periods when short-fall
Key objectives of Dutch risk-scoring model (FIRM)

- Structured risk analysis process
- Induce build-up of internal risk-management capacity.
- Consistency (risk language)
- Resource allocation
- Transparency (internal/external)
Application of FIRM

- Four steps:
  1. Profile of the pension fund
  2. Structure of the pension fund
  3. Risk assessment
  4. Assessment of risk controls
- Inherent risks +/- mitigating controls = net risk
Risk assessment: categories

- Matching risk
- Market risk
- Credit risk
- Insurance risk
- Business risk
- Operational risk
- Outsourcing risk
- IT risk
- Integrity risk
- Legal risk
Control assessment

- Risk-specific controls
- Risk-transcending controls
- Risk-mitigating effects at management level
Overall aggregation of scores

- Algorithm emphasises high risks and poor controls (no averaging out)
- Compare to own judgement
- Combining risks and controls leads to net risk profile
Recent trends are at least partly driven by risk-based supervision

- Fair premium levels
- Conditional indexation of benefits.
- Increased duration of bond portfolio (but not lower share of equity!)
- Restructuring of pension fund industry (concentration, outsourcing).
Lessons learned

- Risk-assessment tool must be embedded in the organisation …
- … and be shared with the industry [www.dnb.nl/openboek/extern/id/en/all/41-117136.html](http://www.dnb.nl/openboek/extern/id/en/all/41-117136.html)
- Risk-scoring can be demanding for supervisors …
- … and must be balanced by common sense
Financial Institutions Risk analysis Method Manual

Chapter 1: Introduction
Chapter 2: Introduction to FIRM
Chapter 3: Breakdown of the organisation
Chapter 4: Key indicators and characteristics
Chapter 5: Analysis of inherent risks
Chapter 6: Analysis of control
Chapter 7: Aggregation
Chapter 8: Reports
Chapter 9: FIRM and supervisory planning
Annex A: Key ratios and characteristics
Annex B: Assessment criteria for inherent risk
Annex C: Assessment criteria for risk-specific control
Annex D: Reports

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