INSURANCE COMPREHENSIVE RISK FRAMEWORK

1. The expected contribution of the insurance sector to G20 priorities

1.1. G20 priorities

A regulator welcomed the panel and introduced the participants. There are many political and social objectives designed by political leaders in the G20 forum in which the insurance sector could play an important role, including filling the prudential gap, especially in the retirement field, supporting a sustainable economy by technology innovation, and stabilising the economy.

1.2. The stabilisation of economies, investing in infrastructure and addressing the challenges related to the ageing population are important and expected contributions from insurance undertakings

An industry representative felt that the insurance industry is naturally placed to tackle these challenges. It has supported economies and the public sector for a long time. Infrastructure investment is a promising asset class for insurance companies, especially in a low yield environment. In infrastructure investments on one hand are elongated cash flows, and on the other there is still some yield, which is attractive to customers and policyholders. Depending on the market, insurance is an important sector for providing people with long term security and safety.

An industry representative stated that Japan had the presidency of the G20 this year, and there had been a special insurance forum on 5 June. The two G20 priorities that are most relevant are a resilient economy and taking care of the needs of an ageing society. A number of positive steps have been taken on the former. Insurance can and historically has played a positive role on resilience, largely on the life side, because it has a natural desire to match long term liabilities with investments from infrastructure onwards. They can help in a market crisis, because companies can look to the cycle and be a natural stabiliser for economies. In general, both the International Association of Insurance Supervisors (IAIS) and the G20 have moved insurance into a place where it can help economies.

A policymaker agreed with what was said. The insurance sector can clearly make a positive contribution towards meeting G20 objectives and towards a strong, sustainable and inclusive society. More specific objectives are long term investments and investments into infrastructure, addressing an ageing population and developing sustainable finance to fight climate change. The sector has to try to leverage the long term nature of insurance companies' commitments to contribute to a sustainable economy and long term investments.

2. Impacts of the framework on the insurance sector

2.1. Possible impacts of the global framework on the ability of insurance companies to contribute to G20 objectives

A regulator felt the issue is the interplay between regulation and the actual contribution of the insurance sector to the G20 objectives. The first objective of the framework is to protect policyholders and contribute to financial stability, but other possible implications need to be focused on.

An industry representative stated that regulation plays an important role there. On resilience, the last financial crisis illustrated that insurance can be a stabilising force for markets. It is subject to regulation, which is not necessarily about enhancing, but more not hindering the natural role and business model that insurance companies have. However, changes have been seen in products and product mixes, partially in reaction to regulation. That is important to be discussed in detail.

2.2. The various aspects of the framework

A policymaker felt that the regulations should not be turned upside-down. Policyholder protection must remain the number one objective of the global regulatory framework, which Solvency II achieved in the EU.

However, it is important that the regulatory framework should not unnecessarily prevent meeting the G20 objectives that were set out.

Regarding long term investments, there are investments into equities, which are held for a long period, and into high quality infrastructure projects. The European Commission tried to look at its rulebook to see if it could be adapted to make sure it could help companies invest more in the long run, without compromising the prudential soundness of insurance companies. Steps have been taken in this direction, notably in the new category of long term (equity) investment, which benefits from a new capital charge of 22%. The Commission will have to see what the impact is, but it is not closed to the idea of going further. It has asked the European Insurance and Occupational Pensions Authority (EIOPA) to comprehensively look at the issue of long term investment, without being solely focused on the capital charge, but by taking a holistic view to see what could be done as part of the 2020 review.

2.3. IAIS targets improving the holistic framework to address emerging challenges

An official believed that that sector can contribute towards solving some of the mega trends and structural issues that are being looked at, including climate risk, inclusive societies and providing for older people. This is recognised in the IAIS strategy, which was agreed by the entire membership in June 2019.

A five year strategy starting from 2020 has been agreed, where the supervisory and regulatory perspectives to climate risk and sustainability, inclusion and the digital economy will be at the heart of the work plan. Once the bulk of the post crisis agenda has been completed by the end of the year then the IAIS will be able to transition to those themes with the full force of its inclusive membership.

There are a number of initiatives in the area of climate risk and sustainability, because these are cross sectoral issues. The model is to partner with other agencies that are working on these issues and to offer the insurance perspective. On climate risk IAIS is working with the UN Sustainable Insurance Forum and has already produced useful material on the supervisory perspective to climate risks.

On inclusion, it is working with Access to Insurance. On other issues the IAIS focuses on insurers where it has a comparative advantage as a standard setting authority. It is doing special work on the risks around cyber underwriting, which only an insurance standard setter can do.

2.4. Making macroprudential surveillance effective

An industry representative felt that the holistic framework proposed by the IAIS in a document that came out in June is going in the right direction.

The holistic framework has a number of key parts, the most important of which is macroprudential surveillance. Monitoring for risks going forward is always the big challenge. The current Financial Stability Board (FSB) Chair, Randal Quarles, said that this is not an area where one can hire four or five experts to find systemic risk; everybody needs to be looking at all times. It is an inherently difficult challenge.

For the insurance sector, one of the most important things is to make sure that something is in place to look at the key risks as they grow over time. One of the key parts of the holistic framework is the liquidity risk assessment. A lot of work is being done on that in Europe.

There are four components to the macroprudential initiative: liquidity stress testing, capital stress testing, recovery and resolution, and counterparty exposure limits. 80% of the very intensive work has been on the liquidity stress framework to make sure that companies know what their top two or three liquidity risks are and make sure that they have enough highly liquid assets to meet short term demands. Surveillance will be key to address those risks.

2.5. The main building blocks of the framework and implementation challenges

An official explained that the holistic framework has four elements. The first is preventative measures which enhance ComFrame and the insurance core principles (ICPs) to address the sources and transmission mechanisms of systemic risk, including liquidity and counterparty risks. The second is preventative measures that enhance supervisory powers to make sure that they can intervene if problems crystallise. The third is the global monitoring framework. The fourth is surveillance risk assessments. The IAIS wants to be as forward looking as possible, as it is difficult to predict the next source of systemic risk. A well run insurance sector should be a stabilising factor rather than a source of risk.

As the global insurance standard setter, IAIS should be in a position to look at the data, examine whether risks are building up in the system, and try to prevent them. It should then challenge its own supervisory community about whether they are doing enough.

At its heart, the global monitoring framework is a sector wide activities based framework. But it is possible there could be significant and material companies that concentrate these risks on their balance sheets, which has happened in recent history. Private sector views on this are important.

One reason there are international standards in the first place is to maintain a minimum competitive level playing field. It is important to maintain implementation and consistency across policy measures, which why is there is an implementation programme and why the FSB is not going to remove the Global Systemically Important Insurer (G SII) status until it is satisfied that policy measures have been implemented in key jurisdictions.

3. G20 objectives and the global capital standard

3.1. IAIS's role and work in process to define the capital standard

An industry representative stated that insurance companies find the holistic framework quite useful and it is hitting the mark. Regarding the development process of the holistic framework, there was a new or newly perceived risk after the 2008 systemic financial crisis. Some ideas were drafted and the IAIS came forward with its initial approach. The industry was not enthusiastic about it, but what worked well at that time was cooperation and discussion between policymakers and supervisors in the industry in tackling this. That process needs to be used as a benchmark for what is done with new emerging risks going forward. When digital is discussed it refers to issues all the way from cyber risk underwriting to the potential systemic risk of cloud providers.

3.2. Challenges for appropriately finalising the Insurance Capital Standard (ICS)

An industry representative believed that the insurance sector has accompanied IAIS developments in recent years. It has participated in field testing and has come a long way. The interesting thing is what the final IAIS 2.0 will look like, which will be completed in November in Abu Dhabi. The uncertainty of what it will look like, illustrates the sector's concern that if there is such a late finalisation then the finer details will always be last minute.

An industry representative felt that the goals of the Kuala Lumpur agreement are good and well intentioned, but insurance companies think that there are still about a dozen outstanding design issues to tie the framework into the G20 goal to have a robust, resilient capital standard that will help protect ageing societies. Companies are concerned about several sources of non economic volatility. There is a need to have some data and an impact study to make sure insurance companies can continue to provide the kind of protections required by ageing populations.

An industry representative felt that the monitoring period of the IAIS and how it operates is in reality a natural extension of field testing. It is understood that it will be completed by 2025, and the sector has heard from IAIS that there will be another consultation, which is welcomed. What is needed however, is a quantitative impact study and comprehensive review of the framework some time in 2021 or 2022 when enough data has been collected, to take stock and establish that 99% of what will be entered into implementation in 2025 is appropriate or if some major tweaks are needed.

Regarding data collection, a speaker stressed that the colleges of supervisors are also important to have direct conversations with the chief risk officers (CROs) of insurance groups. When talking about systemic risk, insurance companies want to hear what is keeping the industry "awake at night". The Insurance Capital Standard (ICS) will be an important bearing point for systemic risk. A microprudential solvency measure is needed as well as a conversation about how it contributes to macro prudential needs. Insurance companies need as much stability in microprudential measures as possible; whenever they have a framework that is a stable base, it becomes valuable and meaningful to put macro on top. But if there is a volatile micro baseline then supervisors will always be tempted to attribute such an instability to emerging systemic risk, even if there is none from the underlying economic risk perspective.

3.3. A monitoring period to addressing material unintended consequences

An official felt that there are now fewer concerns, which is why there will be a monitoring period. The IAIS would like a minimum prescribed capital requirement (PCR), in order to monitor the standard for IAIGs for a number of years with relative stability. It will be addressing all material unintended consequences during this period and there will be consulting. Impacts will be monitored and the IAIS will discuss the nature and timing of impact analysis. The IAIS is not monitoring the companies rather its monitoring the ICS and towards this purpose it wants to get the views of the group wide supervisors, as well as the technical groups within the IAIS. There are fewer than a dozen critical design issues currently on the agenda. There are going to be difficult technical policy discussions ahead of November, but the challenges are beginning to narrow, and the field-testing results are encouraging.

An industry representative felt that the interaction between policymakers, regulators and insurers works extremely well. If it is done for the upcoming risks in the IAIS then the industry will be successful for all its stakeholders.

3.4. Interplay between the holistic framework local regimes and implementation challenges for the EU

An industry representative stated that in the banking world big banks spend a great deal of time competing with each other but compete fiercely with small or medium sized companies complying with differing regimes. If the industry wants a truly level playing field, then it is not enough for the regime to encompass 40 or 50 IAIGs; it is about what is happening in local regimes because historically insurance has been much more locally regulated.

A policymaker thought that it may be too early to jump to Solvency II and how it might contribute to a macroprudential. There is much merit in developing this holistic framework for systemic risk. It can complement the judgment of micro supervisors and provide them, as well as to insurance companies and regulators with valuable information. The framework will be useful in the future, when stress tests are devised, to better define the economic shocks they will assess. In particular it provides common thresholds and definitions that would be applied to all IAIS members. It is important to benefit from a common definition for an internationally active insurance company.

At the EU level, the Commission has to find ways to minimise the data collection burden and that they can use existing data where possible but also the EC has to make sure that IAIS members apply a common language to make data comparable globally. Implementation is crucial. If certain policy measures are agreed, such as liquidity planning or ex ante recovery plans, then they need to be consistently implemented throughout jurisdictions.

A policymaker believed the first lesson drawn from Solvency II is that patience is needed when establishing standards across jurisdictions. Solvency II started development 20 years ago and was implemented 16 years after that, so patience is needed. It is important to do solid ex ante testing of Solvency II. Five quantitative impact studies have been done and the Commission welcomes the five year monitoring period of the IAIS. Excellent participation from the insurance companies is needed. The fora from the quantitative impact studies (QISs) will also be needed for the monitoring period, even if the burden is significant. Ultimately, it is in the interest of the companies to provide the right data.

Ex post evaluation is important, and the EU Commission has to be ready to adjust the standard when it sees problems. The intention is to preserve stability on the Solvency II framework and not make radical changes as part of the 2020 review. There needs to be a willingness on all sides to make political compromises to get to one standard and not one standard plus another, which may or not be comparable. The purpose is to ensure a level playing field and that there is trust in the system. That is best achieved by having only one standard.