INSURANCE SECTOR GLOBAL ISSUES

JONATHAN DIXON

Secretary General, International Association of Insurance Supervisors (IAIS)

Navigating uncertainty: the importance of a global supervisory response

In February, the IAIS published its Roadmap which sets out an ambitious work programme for the next two years during a period of continued uncertainty for the insurance sector given the Covid-19 pandemic. Assessing and mitigating risks to the stability of the global insurance sector, while helping our members to address accelerating risks and opportunities, sits at the heart of the IAIS' Roadmap.

The pandemic highlighted the importance of consistent global standards and supervisory cooperation to maintain financial stability. Despite the significant challenges during 2020, the IAIS progressed work to finalise and implement key reforms such as enhanced global standards on macroprudential supervision (the Holistic Framework for the assessment and mitigation of systemic risk) and the global Insurance Capital Standard (ICS). We also maintained momentum on our supervisory guidance on a range of emerging and accelerating trends, such as climate change, fintech and cyber risk.

The Roadmap presents a broad range of planned projects in four thematic areas: risk assessment and the maintenance of financial stability, including ongoing assessment of potential vulnerabilities arising from the impact of Covid-19.

In 2021, we will undertake our Global Monitoring Exercise (GME), which is an assessment of systemic risk at the sector-wide and individual insurer level and covers more than 90% of the global insurance market.

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Last year the IAIS adapted the GME to focus on the impact of Covid-19. This year we will continue to monitor the impact of the pandemic on the global insurance sector. Running this exercise last year provided supervisors with access to global data so they could share their experience on any emerging vulnerabilities. In December, we published the results of this analysis in our Global Insurance Market Report. It concluded that the global insurance sector had demonstrated both operational and financial resilience, aided by supervisory measures providing operational relief and by monetary and fiscal support measures in financial markets in certain regions.

Delivering on key post-crisis reforms, including further refinement of the ICS during the current five-year monitoring period and the consistent implementation of the Holistic Framework.

Earlier this year we marked an ICS milestone with the completion of the first year of the monitoring period. Despite the operational challenges of 2020, the first year of ICS monitoring saw strong participation and engagement from insurance groups. Participation in the ICS monitoring period will grow in 2021, with additional insurance groups participating.

Importantly, this year allowed for the first ICS discussions amongst group-wide supervisors in supervisory colleges, which provided valuable input and feedback to further enhance the ICS.

The ICS will create a common language for supervisory discussions of Internationally Active Insurance Groups' solvency and enhance global convergence among group capital standards. We are also making good progress with assessing implementation of the Holistic Framework and in the coming months will report on implementation across our membership.

Supporting members in addressing the risks and opportunities of key trends, especially those accelerated by the Covid-19 crisis. Activities include: work to address climate risk and sustainability; supervisory perspectives on the pandemic protection gap; measures to increase operational resilience of insurers; supervisory guidance on responding to FinTech and cyber risk; supporting activities to implement risk-based solvency regimes in emerging markets and developing economies; and new endeavours in the area of diversity and inclusion.

Implementation support and assessment, specifically reinforcing our extensive programme of member support to help insurance supervisors understand and implement our standards, through training, peer exchange platforms and implementation assessment exercises.

Over the next two years, we will continue to work collaboratively with our colleagues in the other international standard-setting bodies and with our broad range of stakeholders on these important topics. We will also embed emerging lessons learned from the pandemic to further improve the cross-border coordination and collaboration we saw between insurance supervisors over the last year.

PETER BRAUMÜLLER

Vice-Chairperson,
European Insurance
and Occupational Pensions
Authority (EIOPA)

ICS: the time to engage is now!

The development of the Insurance Capital Standard (ICS) by the International Association of Insurance Supervisors (IAIS) as part of its comprehensive group-wide Common Framework (ComFrame) for the supervision of Internationally Active Insurance Groups (IAIGs) has been, since its inception, recognized as a key step for the enhancement of global financial stability as well as consumer protection.

It is thus extremely important that EU groups actively engage in the ICS development, enabling the IAIS to collect data from different European business models in order to ensure a proper calibration and risk sensitiveness of the ICS that can match the reality in the EU. It's important for European IAIGs not yet participating in the ICS monitoring period to understand that it is in their own interest to participate, to secure an ICS that continues to reflect the sound basic principles of Solvency II and which can truly foster global convergence and consistency of supervisory practices.

Working with its membership from all over the world, the IAIS has already achieved substantial progress in the development of the ICS, with the agreement of ICS 2.0 in 2019 representing the culmination of that progress.

In EIOPA's view, ICS 2.0 represents a significant step in the direction of the implementation of sound risk-based supervisory frameworks at a global level, enhancing the level playing field for European insurers as well as their competitiveness.

Even before its expected adoption by 2024, the ICS is already shaping the development of supervisory frameworks throughout the world. These should be very positive news both for large international groups as well as for the supervisors in charge of controlling them.

EIOPA has always supported the development of an ICS that reflects the basic sound principles of Solvency II. Such an approach does not mean that the global standard should mirror Solvency II. It is reasonable to expect that a global standard may need to be less granular and allow some limited room for jurisdictions to accommodate national market specificities.

Despite big progress on ICS development, strong engagement on the EU side remains critical.

EIOPA strongly believes that Solvency II should become one of the practical implementations of the international standard. Upon finalization of the ICS, legislators should be open to adjust our European system if that is needed, with the aim that European groups are only subject to a single capital regime.

The development by the United States and other jurisdictions of an Aggregation Method (AM) – not part of the ICS – aspires to measure group capital adequacy by leveraging existing legal entity requirements through simple adjustments and scalars.

EIOPA still has reservations concerning whether reconciling the current diversity in approaches across jurisdictions in such a manner can effectively ensure sufficient comparability and a level playing field compared to the ICS. While we are open to the arguments in favour of the Aggregation Method, EIPOA holds the view that discussions around AM should not distract the IAIS from work needed to complete the ICS.

The High Level Principles for the comparability assessment between the AM and the ICS, recently under public consultation by the IAIS, already provide significant reassurance that the comparability assessment of the AM will be subject to high standards. The assessment will be based on data which should evidence similar results between AM and the ICS over time and under different economic and market conditions, ensuring that the level of prudence under the AM is at least the same as for the ICS.

Let's not fool ourselves: the road towards the finalisation of the ICS is still very long and the effort required is still huge. Nonetheless, effort will be worth it as international standards are the best response to fragmentation – particularly relevant in businesses like insurance and reinsurance that heavily rely on scale and diversification.

The information collected during the monitoring period will by and large determine the final design of the ICS. This is why a high level of participation in the ICS development is so critical. If Europe's IAIGs want to see one single risk-based ICS that reflects the well tested principles of Solvency II and promotes a level playing field between IAIGs headquartered in different parts of the world, then they must take part. Indeed, the time to engage is now.

ALBERTO CORINTI
Member of the Board of Directors, Italian Insurance Supervisory Authority (IVASS)

Lessons learned by insurance supervisors from Covid-19 crisis

What lessons can insurance supervisors draw from the pandemic crisis? At the outset of the crisis, the main response from supervisors would most likely have focussed on the need for emergency and crisis tools. After experiencing more than one year of ongoing crisis, I think the response would mainly focus on lessons for enhancing supervision in normal circumstances. In some way, the pandemic has served as a catalyst and has made visible gaps that are not directly related to the crisis.

The first area to mention is certainly IT innovation. The crisis has boosted the use of digital tools to design, price and distribute products, with a number of implications in terms of collection, storage and use of data. These developments can certainly help to better satisfy consumers' need, promote insurance protection and streamline contract relationships. At the same time, they could expose to risk of market misconduct, endangering consumer protection, or to a number of risks, such as cyber, operational, legal and reputational risks, which are relatively new for supervisors, but represent a potential threat to companies' solvency and financial stability. The challenge for supervisors is therefore to ensure a "healthy" use of technologies. A proper understanding of these changes and their risk implications is the first, challenging goal for supervisors.

IT innovation could also simplify the relationship between firms and supervisors. During the emergency, supervisors took a set of measures to help insurers ensure business continuity. We must now think about whether and how we might permanently introduce simplification in the prudential framework. We should avoid unjustified reporting burden and reduce complexity in supervisory processes. Here I think there is room for improvement in many jurisdictions.

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This leads to another important lesson: it is essential, now more than ever, that consumers remain at the centre of the business. This is not only a principle of good market conduct. It is the only way for companies to reinforce and stabilize their relationship with consumers, which is characterized by a progressive reduction of physical contacts, in a context of dynamic markets with multiple players and innovative ways to design and offer products. How supervisors will promote and enforce this principle will be key.

For example, the extent of lockdowns has not only affected consumer's behaviour, but also the "value" of some insurance products (i.e. MTPL, travel). In this context, insurers should assess potential unfair treatment for policyholders and take remedial actions. In Italy, some companies have lost an opportunity to show their attention to consumers' rights when making this assessment. This is an attitude that supervisors have to address, even though traditional tools are sometimes not effective in this regard.

Another area where the crisis has highlighted the need for improvement is the macro-prudential dimension of supervision. As shown by the pandemic, supervisors should be able to monitor risks that, in one shot, could affect a large part of the sector and generate reactions that, in turn, could impact the financial system. These types of inward and outward risk call for specific tools. We need forward-looking tools, what-if analysis, effective cross border cooperation and proper powers of intervention. This is key in the context of the potential longer-term effects of the current situation.

The expected persistence of low interest rates, the economic uncertainties and the potential materialization of increased credit risk require a supervisory focus that goes beyond the microanalysis.

Finally, yet importantly, the crisis has highlighted a significant protection gap. Households, businesses and professionals experienced a crisis that was unique in terms of size and extent, and often found themselves without the necessary protection. We must now ask ourselves how the insurance industry can improve its ability to protect the society and contribute to a new phase of development in the post-COVID economic system. Here, there is a variety of areas to focus: regulation, solutions for public-private cooperation, technology, insurance product range, distribution networks, insurance and financial education.

This is something that goes beyond supervision, but where supervision should be part of the solution.

STEFANIE
OTT

Head Qualitative
Risk Management,
Swiss Re Management Ltd

After Covid-19 – an even more resilient insurance sector

The ongoing pandemic is not a black swan event for insurers and regulators. This is thanks to the fact that the insurance industry already considered pandemics in their risk modelling. Large systemic events do however unfold in unexpected ways. With Covid-19, we saw unexpected losses in the areas of business interruption and, in particular, with respect to Non-physical Damage Business Interruption (NDBI). On the other side of the balance sheet, the uncertainties in the financial markets, compounded by a low interest rate environment, created challenges.

This unique combination of severe effects on both sides of the balance sheet underscores the systemic impact of the pandemic. So, what lessons can we learn from this pandemic in order to manage a future systemic shock to the insurance industry, and our economies, better?

The Covid-19 pandemic has highlighted the fact that resilient economies need to be built in order to manage systemic shocks. A society that has internal economic buffers is in a much better position to withstand any external shocks that it may face. Resilience to systemic shocks, such as pandemics, which do not diversify, requires a combined effort between the state and insurers. Public Private Partnerships (PPP) would create preparedness for such extreme events by pre-funding the costs. If reinsurers provide their global view and expertise on risk, primary insurers tap into their local network for claims management and states makes use of their logistics and risk bearing capacity, then future extreme events can be withstood much better.

The economic stimulus packages released around the world play an important role in the global recovery effort. These packages should also be used to address issues such as climate change which are pertinent to the insurance industry. For instance, funds should go into decarbonising the energy sector, building climate change resilient cities, protecting public health and to the restoration of natural assets and ecosystem services. This will help ensure that extreme weather hazards, such as hurricane related storm surges, will no longer materialize into huge property losses if we protect coastal wetlands.

The insurance industry coped well with Covid-19 – but there are lessons to be learned for the future

The protection gap is another element that needs to be addressed if we are to make our economies more resilient. Insurers can take the lead in developing solutions and regulators can help by providing the regulatory frameworks needed to facilitate this. Initiatives such as the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) complement regulatory efforts as they force companies to put a price tag on risks that formerly did not appear on their balance sheet.

While it is currently not mandatory, there are over 1000 public and private sector organisations around the world, including Swiss Re, that support the TCFD giving it global credence. Expanding the TCFD's use would help bring about consistency, and improve the quality, of sustainability reporting as opposed to developing new frameworks which may only lead to confusion and hinder the progress that's been made. It is only by jointly developing such frameworks, as well as pooling and sharing data and expertise, that we can move quickly in developing more resilient economies and building new insurance solutions that will close the protection gap.

The insurance industry continues to play an important role in society and, as such, we must ensure that it remains operationally resilient and trustworthy. It is only by taking a global approach, and by making sure that we apply operational resilience frameworks that take the diversity and sizes of different businesses into account, that we can ensure that the industry continues to be society's trusted partner in times of need.

JEAN-JACQUES BONNAUD

EUROFI

Preserving social and economic roles of the Insurance sector in the post pandemic world

The Insurance sector will be confronted with two sorts of challenges in the present and next future.

Firstly, one has to mention the challenges presented by the immense environmental transformations triggered by climate and the sustainability stresses, which produce a growing magnitude and frequency of natural catastrophes such as floods, hurricanes, big urban fires and wildfires, destruction of crops. Not mentioning the possible costs of covering the negative consequences of the sanitary constraints imposed by States on the earnings of firms, whenever they are not entirely addressed by state subsidies, these sustainability stresses will imply massive and unexpected expense increases within the insurance and reinsurance sectors. It is clear that regulatory costs will also be faced by the European insurance sector. They are due to the unexpected increase of these risks and will come in addition to the rising burden of operating costs.

This is no doubt that cost efficiency is thus essential for the sector, which requires these regulatory costs to be evaluated in particular against the necessity to maintain the competitiveness and risk mitigation role of the European sector. This is all the more important in a context of interest rates set at low and even negative levels to address inflation issues, which further inflate the longer-term liabilities of insurance undertakings and related provisioning.

Such evaluation should lead to a renewed concertation between the sector and the EU authorities, regarding beyond the technicalities of Solvency II, on an accurate understanding of these new types of risks.

A second and additional problem, which also questions the regulatory framework, will arise as soon as the end of the Covid19 pandemic will allow for an economic recovery. In this context, worldwide, the States as well as the private sector are projecting to spend enormous amounts of money, which will raise a financing problem.

These expenses are crucial in particular in the EU, to relaunch the economy and address beyond those already planned before the pandemic, the long-term investment in infrastructures of all kinds, e.g., pharmaceutical, renewable energy, new materials, digitalisation, telecoms, … necessary to speed-up to the much-needed green transition and the enhancement of innovation capabilities.

The Insurance sector will be confronted with two sorts of challenges in the present and next future.

Should there not be any increase of interest rates, it would be even more essential to provide the insurance sector with a regulatory framework enabling it to further channel the individual's savings towards long-term equity investments of listed or non-listed companies, well beyond the mere sovereigns and corporate borrowings, the financing of which will be further indirectly supported by ECB non-conventional monetary policy.

Indeed, insurance companies are essential for addressing the financing of these needs. Firstly, they are a privileged channel between the EU economy and the savers, whose ability to assess risk is limited. In addition, due to the specificity of their business model, they have the unique ability to invest in medium to long term horizons, which match with most of the public and private expenses envisaged.