KEY ISSUES IN THE INSURANCE SECTOR AT THE GLOBAL LEVEL

1. How the insurance sector has been impacted by the crisis on solvency and profitability

An expert stated that the insurance sector faced two shocks in 2020. The first was a long-term shock coming from increasing natural disasters. The second was COVID-19.

The Global Insurance Market Report of the International Association of Insurance (GIMAR) indicated that the insurance sector has mainly been affected on solvency and profitability, and less on liquidity and asset exposure. Most reinsurance companies suffered from heavy losses due to claims. The most striking shocks have been in the economic branches of services to industries and transportation.

The lines devoted to household insurance, especially casualty, have been hit less. Sometimes the combined ratio improved. For the reinsurance sector, the consequences were seen at the beginning of the year. Most of the threats have been removed with an increase in tariffs. The solvency ratios have been affected by the financial results in the low interest rates environment. In addition, at the end of the year the various values of the listed companies followed the economics of the sectors to which they belong.

On the solvency side, the sector has been resilient and even if the ratios have diminished the amount of security is there. The real problem faced has been the pressure on costs. It resulted from the digitalisation imposed to deal with the changes in distribution channels and the subsequent evolutions of the organisation of companies, in a context of fast development of remote working due to the pandemic. In addition to cost-cutting, some attention has been given to liquidity. On the asset side, attention has been given more to downgrades of certain corporate portfolios.

An industry representative confirmed that capitalisation is still high. Solvency II regimes worked as intended in helping to preserve the bulk of capital.

2. One challenge going forward is to close the resilience gap in the societies

2.1 Modelling pandemics is challenging

An industry representative stated that much of the data in pandemic models is based on past pandemics. Each pandemic will evolve differently. It is important to note that this pandemic is still ongoing, which means that it is important that the risk of mutations as well as the risk that the pandemic lasts for longer than expected are taken into account when looking at the pandemic.

2.2 Claims regarding business interruption was an unexpected challenge

An industry representative stated that the biggest element of the pandemic that took the industry by surprise is the non-damage business interruption. This followed the decisions by governments to enact lockdowns. These varied greatly from country to country. Even Western, liberal democracies went into severe lockdowns. Non-damage business interruption claims were consequences of lockdowns on the insurance industry.

Public private partnerships are one way of helping society remain resilient when faced with large risks that are very difficult to diversify. Continuous efforts should also be made with regards to the closing of the protection gap.

3. The Insurance Capital Standard (ICS) and the holistic framework for the assessment and mitigation of systemic risk

3.1 The first year of the monitoring period of ICS

An official confirmed that, based on the experience of the previous year, the first of the ICS monitoring period, progress is on track. There was strong participation from volunteer groups and engagement in the first year of monitoring. There was also engagement with supervisors. COVID-19 provided a real-life lens through which to look at the performance of the ICS under a global stress situation.

The prior year taught the importance of having global solutions to global challenges, which the ICS aids with. It helps to provide a common language for supervisory discussions of group solvency and internationally active insurance groups and it enhances global convergence of group capital standards. There is a gathering momentum for increased participation from insurance groups in all parts of the world. Engagement and interaction are needed to ensure that ICS is designed to best capture a range of business models and market characteristics.

3.2 The implementation of Holistic Framework

A regulator explained that one impact of COVID-19 was that the holistic framework was not fully implemented during the year. Nonetheless, the holistic framework was very useful for assessing the impact of COVID-19 globally on the insurance sector. The holistic framework is not a set of rules but more of a process. It is a framework to take supervisory actions.

3.3 Three key ICS building blocks

A regulator stated that there are three main challenges for the success of the framework. The first is the setup of a proper macroprudential assessment at national level. This is the basis for having a clear idea about the sources of systemic risk at the national level and bringing them together at the global level.

The work of IAIS on the application paper on macroprudential supervision is very useful in this regard. The paper includes a number of clarifications on many critical aspects. There may be improvements to make when assessing at jurisdictional level how the sectors could impact the system individually or collectively.

The second critical aspect is having tools that are not only effective but are harmonised in order to measure the sources of global systemic risk. The work of IAIS on the liquidity metric is very important. A liquidity requirement is not needed for insurance; rather, a metric is needed: something that allows measurement of the exposure to liquidity risk at global level. In the future ICS could also be a way of measuring risk.

The third point, which is the most critical, is related to the ability of supervisors to work together and to bring all of the results of the national analyses together to discuss what, globally, the main exposures and the main threats coming from the sectors are.

4. The challenge of the global standards is to achieve comparability and address the various stakeholders' needs beyond supervisors

An industry representative indicated that their firm, as a global company, encourages global standards because it makes life easier to have proper decision-making and comparability. The principle of global standards, whether they are reporting requirements or capital requirements, makes a great deal of sense.

With Solvency II and the Swiss Solvency Test the idea is to have something that reflects the risk profile of the firm the firm thereby providing information that can be used, not just to manage the company but also by stakeholders. It has to be similar to what competitors are doing in order to see how resilient the industry is overall.

4.1 Key points of attention during the monitoring period to achieve comparability: improving the representation of the reinsurance sector, internal models, reducing national fragmentation

An industry representative noted that the holistic framework and ICS need to be well thought through so the comparability makes sense. The reinsurance industry is, on the ICS side, not sufficiently well represented in order to have a risk profile that reflects their firm properly as a global player. The firm also worries about the use of internal models. Over the years it has tried to develop internal models to reflect the risk profile more accurately, thereby helping the decision-making of senior leaders and providing comparability for the shareholders.

The other challenge is fragmentation. There is a counterbalancing of local jurisdictions wanting to stick to what they know because that is how they work, whether it is on the regulatory side or the industry side.

4.2 Producing global standards-related data is burdensome and they pose confidentiality and cybersecurity concerns

An industry representative noted that there are large amounts of data to deliver, and sometimes it is not known where that data will go. There are therefore various risks around confidentiality and the hacking of regulators' or international trade associations' systems. The firm, as a risk knowledge company, is aware that it cannot always completely mitigate everything. These risks are however, weighed to determine whether the effort really is worth the expected outcome. The internal model or the comparability between national jurisdictions, if they apply the ICS, will be key to believing that this will help the industry.

5. Trends shaping the insurance industry

5.1 Assessing and supervising the impact of climate change on the global insurance sector

A public decisionmaker noted that there are huge ongoing projects that will shape the insurance industry. There are emerging risks and issues that need to be dealt with sooner rather than later, for example cyber risk, digitalisation and sustainability. The IAIS is involved in those key challenges.

An official stressed that for climate risk, the insurance sector needs to be front and centre in helping to manage a smooth transition to net zero, and that insurance supervisors also have a key role to play.

This has thus far been achieved through the work on risk assessments and assessing the impact of climate change on the global insurance sector, as well as through the work on developing supervisory practices. An application paper is being finalised, which will be a comprehensive guide for insurance supervisors on how to build climate considerations into their day-to-day supervisions.

On the asset risk assessment, there is already good work looking at climate risk to insurers' investment exposures. It would be interesting to look at the liability side as a next step. There are many scenario analysis and stress-testing exercises being undertaken in different jurisdictions. If it is possible to contribute to global convergence or standardisation around that, that would be very helpful.

IAIS will also have a stocktaking of its principles and standards to identify any gaps. The IAIS' work is being carried out in coordination with the Financial Stability Board, which is looking at a cross-sectoral assessment of stability risks from climate change. The IAIS is contributing an insurance sector perspective to these discussions.

5.2 Sustainability risks: addressing both the physical and the transition risks requires insurance companies to reinvent themselves

An industry representative noted that for sustainability as a bucket it is important to understand the difference between the physical risks and the transition risks. Transition risk is reasonably new. Many in the industry also subscribe to the Paris Agreement and net zero by 2050, but it is a huge challenge across the globe. For the industry, it is important to not only start stepping out of certain areas and industries, but also to encourage them to reinvent themselves and to look at the opportunities available.

6. Key supervisory and regulatory challenges for the coming years for both the sector and the supervisors

6.1 A combination of traditional risk exacerbated and new risk emerging challenge the industry and the supervisors

A regulator stated that the current risk context is very complex because there are traditional risks, such as those connected to the low interest rate environment, the exacerbation of credit risk due to COVID-19 and other still important traditional risks like the ageing population. In addition, new risks are now increasing in their relevance. There is for example the market conduct, operational and reputational risks coming from digitalisation, , cyber risk, climate risk. For supervisors, the problem is keeping up with this risk development. Supervisors should be well equipped and well-resourced to deal with this new context. Europe has the added value of Solvency II, which is already a risk-based system, and so could be used for dealing with the new risks without changing the framework.

6.2 Digitalisation is changing business models in the insurance sector

A regulator stated that digitalisation is a reason for changing the business model of insurers. This will be an important challenge for supervisors who, at a national level, do not always have the relevant expertise and knowledge. The challenge is to promote the development of digitalisation within a safe context, because it presents an opportunity for companies and consumers.

6.3 Technology is where the new area of risks is coming

An industry representative stressed that with cyber-attacks it is a matter of when an entity will be attacked and how they can protect themselves. For companies going into the public cloud there is only a handful of suppliers which are very concentrated, so there is concentration risk. Technology is also evolving very quickly, so there is upskilling risk.

6.4 Addressing the protection gap in a changing world

A regulator noted that, as the COVID-19 crisis has stressed, the protection gap is a major issue for households, companies, and society in general. It is important to take care of aspects like the prevention of risk and the possibility to cover catastrophic events. Supervisors are not the main actors in this regard but should be part of the solution.