Global priorities for the insurance sector

1. Structural shifts and evolving business models in insurance

1.1 Alternative investments: addressing savings gaps with risk and regulatory considerations

A regulator highlighted that after a long period of low interest rates in the US, insurers are increasingly pushing to find yield while managing their risks, and those assets have performed quite well, but there is not as much transparency there. There are efforts to lessen reliance on rating agencies in understanding credit risk. There has been stress testing of collateralised loan obligations (CLOs) and collateralised fund obligations (CFOs), a redefining of bond classifications and associated capital charges, and residual tranches have been looked at. There are attempts to ensure a tailoring of regulations to reflect actual risk levels while acknowledging the need for life insurance products to address retirement savings gaps, particularly given that 40% of Americans currently lack any retirement savings and so, without a robust social safety net in the country, there will be reliance on life insurance products and similar.

A regulator detailed that structural shifts in the life insurance sector involve increased investments in alternative assets, and greater reliance on cross-border asset-intensive reinsurance. While the global insurance sector's exposure to alternative investments is currently limited, significant exposures exist, requiring careful assessment of their implications for supervisors and regulators. Potential risks include valuation issues, liquidity risks, and conflicts of interest at the micro level. At the macro level, concerns extend to regulatory arbitrage, concentration risks, both within jurisdictions and individual insurers, and recapture trigger risks. The International Association of Insurance Supervisors (IAIS) has published an Issues Paper providing a comprehensive analysis of these shifts and outlining potential areas for future investigation, which is currently open for public consultation. The IAIS, encourages feedback from stakeholder until 2 June.

1.2 Building Resilience in Long-Term Insurers through Governance, Earnings Stability, and Risk Modelling

An industry representative emphasised that there is a potential temptation for companies to follow suit if some pursue a strategy of incorporating alternative investment assets into portfolios, and it is important to have expertise in understanding and managing these products both on the industry and regulatory sides. That necessitates regulatory oversight to avoid unintended incentives such as overly generous reserving of benefits for risk assets or misaligned capital requirements. Effective management requires both industry competence and appropriate regulatory structures, ensuring customers benefit from these necessary long-term products without undue risk exposure.

1.3 Complementary views on investment and resilience strategies

A regulator observed that within the supervisory world, there is a need for international collaboration, underpinned by the shared goals of supporting industry resilience, and enabling it to thrive, and consumer protection. With those goals in mind, much can be done internationally on standards. Principle-based standards are minimally harmonised, and so permit variable implementation, and how that is done can be discussed. Success is dependent on communication and addressing vested interests. It is more difficult where there are pre-existing practices than where there is a new risk emerging.

A regulator commented that the US is better at adding components than it is at subtracting and simplifying, but it is actively working towards simplification of its risk-based capital system by reviewing existing regulations and considering factors such as climate risks, wildfire exposure, and life insurance residual tranche risks. The attempt at a holistic approach aims to promote convergence, because the industry will be able to see more consistency, even if complete harmonisation across jurisdictions remains unattainable. The best to hope is the promotion of convergence and bringing participants along.

2. Supervisory and regulatory challenges in a fragmented global market require greater international regulatory convergence and harmonisation

2.1 Fragmentation risks call for global convergence

A regulator remarked that one of the IAIS's core objectives is to achieve a globally consistent and comprehensive implementation of its standards and to this end, the IAIS finalized the Insurance Capital Standards (ICS) for Internationally Active Insurance Groups last year. The IAIS also undertook an assessment of whether the US Aggregation Method (AM) provides comparable outcomes to the ICS, which helps ensure convergence on an outcome basis.

As the strategic plan shifts from robust standard setting to implementation, the aim is to have the first ICS implementation assessment in 2027. For 2025, the IAIS will focus on producing the High-Level principles for the ICS. The aim is to have a consistent perspective of this implementation assessment including the USAM, which is important for alleviating some of the concerns around supervisory fragmentation.

An industry representative highlighted that although regulatory fragmentation's impact on resources is a key concern for global reinsurers, a more fundamental issue lies in the obstacles this fragmentation creates when attempting to address globally relevant problems such as climate change. One concrete example among many others: multiple jurisdiction-specific climate-related disclosure reports have to be produced on the same topic, hindering transparency and diverting resources from more effective efforts towards transitioning to a more sustainable economy. Many of those national requirements are based on the same underlying framework and arise despite regulatory commitments to the reports being interoperable. Regulators should work towards a more streamlined and effective approach to global regulatory standards, through ongoing dialogue and collaboration in international fora such as the IAIS.

2.2 Perspectives on regulatory coordination and implementation

An industry representative emphasised that the diverging legal and regulatory frameworks necessitate increased compliance resources, all while financial markets exhibit greater volatility than in the past. Reputational risks are heightened when conducting business across jurisdictions with conflicting interests, posing challenges to long-term engagement. The question that arises is how long an entity believes it can do business in two jurisdictions that are in conflict with one another.

A regulator suggested that the approval of the Insurance Capital Standard (ICS) was a significant milestone, achieved after years of development and the comparability assessment for the US regime. The IAIS is now developing an implementation and compatibility assessment methodology to ensure consistent application of the ICS in jurisdictions with appropriate local flexibility.

3. Enhancing risk coverage through coordinated legislative and supervisory action

3.1 Promoting insurance uptake via education, public-private partnerships, and tailored regulation

A regulator stated that insurance fundamentally protects communities against risks to property, liability, human life, and stabilises markets by channelling long-term savings. Without policyholders, there is nothing to protect. The integrated effects of the protection gap extend beyond direct financial losses, and indirectly hinder economic growth, potentially leading to political instability, which in turn undermines financial stability.

Regulators with mandates encompassing only policyholder protection and financial stability have a vested interest in reducing the protection gap. For regulators that also have responsible innovation on their mandates, and those with financial inclusion, market development or competitiveness as goals, it is even more applicable. These are six key actions for regulators. First is the core business of developing and implementing solvency regimes that ensure policyholder protection and market stability. Second is contributing to the development of innovative solutions addressing the protection gap. Third is enhancing financial literacy and education to increase insurance and reinsurance uptake. Fourth is collaborating with public authorities and industry on insurance schemes and public-private partnerships. Fifth is elevating the issue at high-level policymaking forums like the G7 and the International Insurance Society (IIS). Sixth is adopting a multipronged approach combining public intervention, economic policies, partnerships, and increased insurance adoption.

3.2 The reinsurer's role in enabling risk transfer innovation

A regulator warned that, although the dynamics driving the cyber risk protection gap are well understood, there is less understanding of the savings gap, particularly for asset-intensive insurance products. A key driver of this disparity is demographic shifts, specifically an aging population in some developed markets that lack robust social security systems, such as the United States, leading to increased demand for annuity and guaranteed return products, subsequently driving growth in asset-intensive reinsurance. This trend differs in Europe, where demand for these products remains low. Bermuda's asset-intensive reinsurance provisions from the EU decreased over three years from \$17 billion to \$13 billion, representing only 0.12% of total life reserves within the EU and just over 1% of Bermuda's life reserves. Simultaneously, public markets demand traditional capital returns, prompting private capital investment in these products.

The Bermuda Monetary Authority (BMA) has contributed to reducing the global protection gap through its solvency regime, which has been deemed fully Solvency II equivalent and National Association of Insurance Commissioners (NAIC) reciprocal and qualified jurisdiction that has served the commercial market well. Over the past eight years, its property and casualty (P&C) insurers have paid over \$455 billion, \$47 billion of which to European policyholders. Meanwhile, insurers and reinsurers have in the same period paid \$417 billion in life claims, \$16 billion of which went to EU policyholders. Bermuda's vibrant insurance-linked securities market has contributed to the reduction of the protection gap in natural disasters. In the past year it issued its first cyber-linked catastrophe bond, and it has a captive market that helps governments and institutions further contribute to the gap reduction.

In terms of savings and retirement, there is a need for innovative solutions. Asset-intensive, when done well, can also reduce the protection gap, but there are important risks. That business model has idiosyncratic risks that demand intensive supervision, so there have been supervisory and regulatory changes encompassing the valuation of reserves capital requirements, stress testing liquidity, public disclosure and supervisory reporting, including the approval of all long-term transactions. In combination, this has resulted in a material increase in the total asset requirement while still allowing the market to function.

An industry representative noted, regarding AI, that, while there are benefits, there are real challenges related to privacy, liability, cybersecurity vulnerabilities, and potential algorithmic bias. Firms can adopt responsible AI principles to promote transparency, auditability, data integrity, and adherence to legal and ethical boundaries.

Regarding climate-related risks and addressing the protection gap, insuring those risks remains fundamentally possible. It is not an issue of a lack of supply, particularly in Europe with its global reinsurance leadership. The primary challenge lies in affordability in certain cases. There are two possible strategies for tackling that. One is loss prevention measures to structurally narrow the gap by reducing damage risk to property and infrastructure. The second is expanding insurance coverage. Reinsurers and insurers have a crucial role in both areas, by incentivising loss prevention through pricing signals and stakeholder engagement, and innovating data analytics and distribution to expand coverage to underserved risk pools. Progress has been made, as evidenced by the fact that insurers and reinsurers are now able to design cover for risks previously considered uninsurable.

An industry representative added that, on the geopolitical side, the implications for international insurers are that tackling global risks such as climate change, cyber threats and pandemics will become significantly more difficult, in part due to decreasing governmental collaboration. Such a decrease being due to the tensions that are present will make it more challenging to find holistic solutions. International risk diversification is also becoming increasingly complicated, impacting underwriting practices, investment portfolios, and ultimately increasing the cost of insurance provisions.

The industry cannot afford to respond to each of those elements of geopolitical crisis. A holistic framework is needed that is capable of navigating continuous volatility and uncertainty, rather than responding to individual crises in isolation, whilst also recognising that in times of uncertainty and volatility there is a flight of trust. Opportunities arise from increased consumer demand for trusted partners during times of instability and continuous crises, particularly regarding protection gaps and retirement planning. The industry and individual insurers should provide the level of trust and the services customers need, as that will generate a great deal of business. The value of insurers is heightened during such periods of uncertainty, and they must be at customers' sides, on the condition that they are trusted partners.

4. AI-driven transformation in insurance: enhancing speed and precision in claims and customer service

A regulator insisted that supervisors need to communicate. There is significant anxiety around the AI Act in Europe, but if an insurer states it has to do a great deal because of that act then that is a concern. There is nothing in the AI Act that is not already in Solvency II. Supervisors should prioritise clear communication about the expectations, which are not different from those that already exist, and should work together with the industry to harmonise regulatory approaches to facilitate innovation and allow this new technology to deliver what it can to improve things, all while effectively mitigating risks.

5. Unified consumer protection and conduct standards for resilience and market efficiency

An industry representative suggested, regarding the balance sheet, that careful consideration should be given to the level of the firms' reserves, its asset quality, its portfolio diversification in an increasingly fragmented geopolitical landscape, and there should be scrutiny of volatility assumptions. In terms of governance, a strong internal oversight culture where individuals feel empowered to raise concerns is essential. Adherence to regulation and collaborative engagement with supervisors are also crucial components of this holistic framework, as that enables entities to navigate economic challenges effectively.

Gaining customers' trust involves having high-quality services, being responsive at the moment of a crisis, and having engaged employees, which again relates to the need for a holistic approach underpinned by a thorough understanding of how crises are interconnected.

A regulator stated that there is a need for a holistic European perspective focused on creating a single market for conduct and consumer protection, allowing member states to function together rather than them competing with another. There is not a single market on the conduct side, and that should be worked on at the EU level. There should be simple and holistic regulatory design, given the shared goals there are.