Major emerging risks in the insurance sector

1. Macro-financial and geopolitical threats call for new supervisory approaches

1.1 Macro-financial shocks and fragmentation are currently the most disruptive risks

A regulator noted that the sector faces a convergence of geopolitical risk, geoeconomic fragmentation and macroeconomic shocks, which currently present the most serious challenges to insurers, particularly in emerging markets.

A regulator stated that the nature of risk is changing, so there is more complexity, more uncertainty and more interconnectedness.

A regulator highlighted that there is currently a combination of fragmentation and geopolitical risk on one hand, and a simplification agenda that is welcomed. However, deregulation and a significant lowering of buffers is a risk for the industry.

An industry representative observed that a critical risk for the insurance industry is mitigating the protection gap, particularly around critically-important areas such as climate risk and cyber risk.

1.2 Geopolitical instability challenges long-term planning and requires diversification

A regulator stated that European insurers are facing growing geopolitical instability and political fragmentation, also due to their engagements in e.g., CESEE. Such uncertainty makes long term business planning difficult. Supervisors are promoting diversification and improving the measurement and risk assessment of geopolitical risks.

1.3 An aging demographic puts pressure on insurance models and customer segmentation

A regulator explained that the aging demographic creates pressure on pension systems, public debt, and insurance business models. Insurance companies must meet divergent expectations from younger, tech-savvy clients and older customers who prefer personalised service, all while controlling costs.

An industry representative added that the younger generation is looking for something simple that they can do digitally. Expectation has maximum protection, never loses any money and is free, but that is not mathematically possible. Some younger people have bought an insurance based investment product (IBIP) on their phone by scrolling through the terms and conditions without reading them.

2. Climate and cyber risks are intensifying, demanding better modelling and public-private cooperation

2.1 Secondary perils dominate losses and widen the protection gap

An industry representative explained that their company models over 400 peril territory combinations around the world in terms of its natural catastrophe modelling, which is split between risks termed as primary and secondary. However secondary risks such as wildfires, floods and hailstorms now account for over 60% of natural catastrophe losses.

Events like the LA and Spanish wildfires, extreme flooding in Valencia and Dubai, and hailstorms in Italy exemplify the increasing frequency and severity of such events. A severe convective storm in the US is now a bigger peril from a loss point of view than hurricanes. The protection gap remains wide, especially in developed economies, where insured losses lag total economic losses.

2.2 Cyber risk is rising sharply but lacks consistent modelling and oversight

An industry representative observed that cyber risk is sharply rising, with an average of over 2,000 daily cyberattacks. Additionally, supply chain disruption and post loss amplification are compounding risks.

Cyber risk has grown to around $17 billion of gross premiums written (GPW). But there is more to do. There is a great deal of nervousness around cyber risk. The industry needs to invest in cyber modelling and in understanding the risk, as well as investing in better telemetry and better education.

2.3 Bridging the protection gap requires pan-European PPPs and innovative instruments

An industry representative stated that addressing the protection gap requires more public-private cooperation. Expanding the catastrophe bond market and using parametric solutions can attract more capital market participation. Governments can support functioning markets through backstops, building code enforcement, and mandatory insurance schemes. National initiatives should evolve toward pan-European approaches, given the cross-border nature of many climate risks.

A regulator commented that public-private partnerships (PPPs) are appropriate when the market reaches its limits in covering systemic tail risks. Governments must help ensure risk awareness and promote insurance uptake to expand the risk pool and improve resilience. Differentiation is needed between markets needing development and those requiring backstops.

3. Investment shifts towards alternatives require solvency frameworks to adapt without deregulating

3.1 Alternative assets are growing but raise governance and risk oversight challenges

A regulator commented that investment strategies are evolving as insurers increasingly turn to alternative assets, including private equity, hedge funds, and real estate. Alternatives are growing, bringing added complexity. This requires regulators to update solvency models to better capture the risk profile and ensure asset preservation for policyholders. Regulatory frameworks must evolve carefully, balancing innovation with consumer protection.

Insurers are going to need ways to be more aggressive on the investment side, but at the same time protective of those assets in a way that a free market without regulation in the industry can take those risks. However, that level of risk cannot be allowed in a regulated industry, because of the payout at the other end and what it means for society. There will be changes around what insurers invest in. Investment outside the US in foreign investments is sharply decreasing, which could affect emerging markets. The cycle of interconnectedness cannot be ignored.

A regulator stated that the EU has a very robust framework in Solvency II, the Insurance Distribution Directive (IDD), and the guidance that has been given to supervisors. There is no need to have additional requirements on sustainable risk plans and transition plans, as the EU has the own risk and solvency assessment (ORSA) in place. 13% of insurers did not take climate risk into their ORSAs, compared to two years ago when only 13% included it.

3.2 Insurers must balance public policy expectations with fiduciary and solvency duties

An industry representative stated that insurers face conflicting expectations from policymakers and supervisors, as they manage policyholder funds and must balance public policy objectives with their solvency and investment mandates. Insurers cannot act as free-market investors; investment strategies must align with long-term liabilities and consumer protections. Policy discussions on capital allocation need to be grounded in the reality of insurers' fiduciary duties and regulatory constraints. Zero risk is not realistic.

3.3. Proposed Solvency II changes risk deregulation without improving resilience

A regulator highlighted that Solvency II changes risk veering into deregulation, especially around lower capital buffers. Proportionality and more technically grounded industry supervisor dialogue are needed. Supervisors can have a dialogue on whether they are capturing the risks. There is a three-year review of the natural catastrophe (natcat) risk model. There is active participation of both the supervisors in the member states as well as the industry on identifying what risks need to be added. Risk needs to be added to the natcat model, because more is happening.

€10 trillion in assets in the EU are invested in alternative assets, which equates to 16%, but the majority of that is real estate mortgages, which the EU is used to. 2.3% is private equity and 2.1% is private credit.

A regulator stated that she would advocate for reducing bureaucracy. Simplification is less bureaucracy at significant points, and less bureaucracy means that a possible reporting reduction should be examined. Examination is needed of the data that is submitted to supervisors regarding its actual usage. In addition, the further use of European data sources should be considered.

A regulator concluded that a clear and meaningful dialogue between industry, politics and supervisors is needed. Supervisors need to be informed about what data is less burdensome, but with the same content. Everyone can then work together to safeguard financial stability and ensure functioning financial market.

4. Climate risk integration and supervisory tools must evolve with emerging threats

4.1 Climate risk integration into underwriting and investments requires a common language

An industry representative noted that insurers have relied on catastrophe models for a long time, which now incorporate climate risk. Their company has developed climate-conditioned models along multiple future pathways and high-resolution risk maps to enable insurers, banks, and asset managers to use a common language of risk. These tools allow integration of climate risk into both the underwriting and investment sides of insurers' balance sheets. There is an importance of understanding how interconnected risks interact across portfolios and regulatory frameworks.

A second aspect of government is looking at building codes and where properties can be built. Hurricane Ian went through Florida in 2022, and many construction properties were rebuilt to building code. When Hurricane Milton went through Florida in 2024, the properties that were built to code performed well, but ones that were not built to code performed much worse. The third aspect of government is in encouraging insurance purchase. Some mandates on purchase that are being put in place will create a better functioning market.

4.2. Backward-looking models and third-party AI tools pose new supervisory challenges

A regulator observed that there are concerns around the use of third-party AI models, the relevance of backward-looking models in rapidly changing risk environments, and the treatment of alternative investments.

A functioning single market is highly necessary for the EU to thrive. The first concern is the uptake of insurance, particularly on the life side. Distribution channels are going to be essential to reach people, as well as the sale of products through those channels that offer value for money. For the intermediaries, the distribution is going to be a big part of how to build the future of citizens when it comes to pensions, and when it comes to protecting themselves from natcat.

4.3 Proportional and harmonised supervision is essential to prevent fragmentation and loopholes

A regulator highlighted that supervisors support proportional, harmonised regulation that balances simplification and risk coverage. Poorly coordinated simplification could open risk loopholes. A constructive dialogue between industry, policymakers, and supervisors is essential to determine which requirements are necessary.

5. Reconnecting with the insurance core purpose in a changing customer and distribution landscape

5.1 Customer expectations for digital and personalised products challenge the risk pooling model

An industry representative noted that consumers demand simple, digital, personalised products, which is an ideal often at odds with the principles of risk pooling and probability-based insurance. More needs to be done to convince insurers that projects are going to match the obligations that companies have. The public policy side needs to be more structured.

5.2 New distribution platforms must be aligned with insurers' core risk functions

An industry representative questioned whether new distribution structures such as bank assurance or tech platforms align with insurers' core functions. The main political risk in Europe for most insurance companies is the maintenance and further integration of the single market. Companies are now thinking about whether there will be a true single market for insurance. Simplification cannot mean minimum harmonisation, because that exacerbates the risk. The aim is to pool similar risks in one place, but questions remain about where those risks are re-insured, how and where they get pooled, and where they are most efficiently pooled.

A regulator highlighted that differentiation is needed between a market that is still immature and that needs to develop further, and where the market is dealing with a systemic risk and has reached the end of that tail, where it will need support. This is where care is needed, because private markets should deal with the risks where they can, but it is impossible to do that without governments also being part of the dialogue with insurers and society

5.3 Resilience through education and mitigation is the most effective form of risk management

A regulator stated that resilience must be a shared priority. In the US, states serve as innovation hubs for joint mitigation efforts. Programmes like Strengthen Alabama Homes are promoting resilient construction, reducing claims and improving outcomes. Public education through multiple channels is vital to ensure consumers value and pursue resilient solutions. Preventing losses through resilience is the most effective form of risk management.